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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-808

ANTHONY M. NATELLI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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No.

ANTHONY M. NATELLI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner Anthony M. Natelli respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit affirming his conviction for violation of Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff.

OPINIONS BELOW

The opinions of the court of appeals affirming petitioner's conviction and, on rehearing, reinstating the

conviction of codefendant Joseph Scansaroli have not yet been reported and appear in Appendices A and C, respectively, of this petition.

JURISDICTION

The judgment of the court of appeals affirming petitioner's conviction was entered on July 28, 1975. A timely petition for rehearing was denied on November 5, 1975. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent portions of the Sixth Amendment and of Sections 27 and 32(a) of the Securities Exchange Act of 1934 are set forth in Appendix E, *infra*.

QUESTIONS PRESENTED

1. Whether, in a prosecution under Section 32(a) of the Securities Exchange Act alleging that an independent professional accountant "willfully" and "knowingly" submitted a false financial statement containing *unaudited* figures, the accountant is entitled to instructions explaining that the professional obligations regarding unaudited financial data are different from those involving figures he has audited.

2. Whether the conviction of an independent professional accountant for "willfully" and "knowingly" making a materially false statement in violation of Section 32(a) of the Securities Exchange Act can be

based merely upon a finding that, though ignorant of the alleged falsity, he acted with a "reckless disregard" of the true facts but without a *conscious* purpose to avoid learning the truth.

3. Whether, in a prosecution involving multiple specifications of unlawful conduct contained in a single count, a general admonition that the "verdict" must be unanimous is sufficient to implement the Constitutional requirement that the jury must be unanimous on at least one particular specification before it can convict.

4. Whether the court of appeals erred in confining "to the facts" this Court's decision in *Travis v. United States*, 364 U.S. 631 (1964), and in permitting a prosecution for making a false statement in a document "required to be filed" with the SEC to be brought in a district other than the one in which the document was required to be and was in fact filed.

5. Whether petitioner was denied a fair trial when the government withheld crucial facts from and made affirmative misrepresentations to the jury.

STATEMENT

A. Introduction

This case presents important and recurring questions regarding the obligations of independent professional accountants under the Federal securities laws as they are enforced by criminal sanctions—in particular, whether an accountant is obliged to question unaudited figures in the same manner as audited presentations are scrutinized, and whether his failure to do so can support a conviction under a statute declaring it a felony to make a false

statement "knowingly" and "willfully." By the Government's own concession, this prosecution is the focal point of an attempt to fashion new standards of civil and criminal liability for accountants and lawyers.[1]

Petitioner Anthony M. Natelli, together with co-defendant Joseph Scansaroli, both certified public accountants, were convicted of "knowingly" and "willfully" making false or misleading statements with respect to material facts in a proxy statement issued by the National Student Marketing Corp. (NSMC) and filed with the SEC in September 1969. At all relevant times, petitioner was the partner in the accounting firm of Peat, Marwick, Mitchell & Co. (PMM) in charge of the firm's engagement to serve as independent accountants for NSMC. Co-defendant Scansaroli was the supervisor on that engagement, working under petitioner's general direction. The multi-count indictment that named petitioner and Scansaroli also charged five officers of NSMC with various violations of the securities laws and

[1]On the fifth day of trial, October 29, 1974, The Wall Street Journal described this prosecution as a "test case in the government's effort to enforce the securities laws against auditors and lawyers." Subsequently the Government submitted to the trial court a memorandum by the Chief Accountant of the SEC, acknowledging that he had been the source for the newspaper story as a result of an interview with the reporter involved.

The article, which also attributed to the source the statement that "if we can't get a conviction here we never will," was the subject of a defense motion for a mistrial on the ground of deliberate government misconduct in generating prejudicial publicity. The trial court, while not condoning the conduct of the SEC's Chief Accountant, denied the motion on the ground that the article had not "infected" the jury. (Tr. 2434). Petitioner argued on appeal that a defendant should not have the usual burden of showing prejudice where he seeks a sanction against prejudicial publicity that high government officials have deliberately planted in the press.

the conspiracy and mail fraud statutes. Four of those officers pleaded guilty to various counts prior to trial, and the trial of the fifth was severed. Scansaroli's conviction was first reversed by the court below and then reinstated on the government's petition for rehearing.[2]

We are constrained to express our belief at the outset that the court below, apparently relying on the government's brief, rested on unwarranted inferences from the evidence, even when that evidence is viewed in the light most favorable to the government. Accordingly, we note the relevant instances where the court below, in our view, diverged from what the jury fairly could have found.

B. The Audit of NSMC for Fiscal Year 1968

PMM was engaged to serve as independent accountants for NSMC in August 1968, two years after the company's formation. A different firm had previously performed accounting services for NSMC, including those incident to its first public offering of stock in April 1968. PMM's first task was to perform an audit of the company's financial statements for the fiscal year ended August 31, 1968. In the course of this audit, a question arose as to whether the income accrual used by NSMC for that fiscal year conformed to accepted accounting principles.

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[2]Scansaroli's petition for rehearing of the decision reinstating his conviction is now before the Court of Appeals.

NSMC had been formed in 1966 to provide promotional and marketing services to companies desiring to sell their products to college students. Through a system of student representatives, NSMC offered its clients the opportunity to distribute promotional materials on campuses and to solicit business from students. Initially, NSMC's programs were designed to elicit a direct response from students to the client—such as the return of a coupon or order form in response to a mailing or poster—and NSMC was paid an agreed amount for each response. In 1968, however, NSMC began concentrating on securing fixed-fee contracts, proposing a promotional program tailored to a client's products at a fixed price. (Tr. 330-331, 335-338, 1826-1831).

Because the bulk of NSMC's work was completed by the time a proposal was prepared for a client, NSMC accrued as revenue a substantial part of the price of any proposal a client had agreed to accept. This procedure permitted the revenue a client would ultimately pay NSMC to be matched against the expenses the company incurred to develop the proposal. An independent CPA who advised NSMC prior to PMM's engagement had accepted the company's accrual of revenue upon representations by account executives that client representatives had orally promised to buy fixed-fee programs, and revenue so accrued was reflected in an unaudited nine-month earnings statement issued by the company for the period ended May 31, 1968. (Tr. 303-307, 469-482, 1494-1498, 1831-1832).

Petitioner initially was faced with the decision whether to object to this accrual of revenue. After

considering alternative accounting methods, including a suggestion by NSMC's president that the *total* fee on any commitment should be accrued, petitioner concluded that continued accrual of a *portion* of committed fees would not be improper, provided that company records allowed calculation of the accrued proportion. Under this "percentage of completion" accounting method, the accrued proportion was the percentage of the total estimated time to be expended on a contract that had been invested by NSMC during the fiscal year in question. (Tr. 1494-1498, 1830-1838)

Before accepting this accounting treatment, petitioner directed Scansaroli to verify directly with NSMC's clients the commitments recorded by NSMC and to obtain documentation from NSMC that would permit calculation of the appropriate completion percentages. Scansaroli met with NSMC account executives, reviewed their files, and made telephone calls to randomly-selected NSMC clients. A schedule from NSMC's comptroller and forms signed by account executives showed the gross amount of each client's commitment, the estimated cost to be incurred by NSMC for printing and distributing promotional materials for that client, and the account executive's estimate of the completion percentage. (Tr. 1921-1939 196, 1501-1505, 1838-1843; Gx3)

Income accrued in this manner appeared in the audited financial statement as "Unbilled receivables and estimated earnings on contracts in progress," and the percentage-of-completion method of accrual was fully explained in a footnote. (Gx. 5, pp. 19-20.)[3]

[3]The court below suggested that the accounting method used for the 1968 audited statement was "contrary to sound accounting practice" and furnished petitioner with a motive to falsify subsequent records in order to escape "severe criticism and possible liability." App. 13a. There was no evidence at trial, however, that percentage-of-completion accrual violated accepted accounting principles, and the CPA advising NSMC at the time of the unaudited nine-month statement published in June 1968 had

BLEED THROUGH

C. Petitioner's Post-Audit Communications with NSMC

Soon after completing the audit in early December 1968, petitioner advised NSMC's officers to improve the company's record-keeping procedures. At a meeting attended by NSMC's president, comptroller, and general counsel, petitioner stated that in the future the company should record income on a fixed-fee proposal only when a client made a written commitment. A few days thereafter, NSMC's counsel prepared a letter contract to be used for future commitments for fixed-fee programs, and petitioner was advised of counsel's judgment that such a letter would constitute an enforceable commitment. (Tr. 206-211, 490-492, 530-532, 673, 1845-1850; Natelli Ex. G)

In April or May 1969, petitioner learned from NSMC's general counsel that Robert Michaels, formerly the Director of Marketing for NSMC, had been fired for taking bribes from certain suppliers and that a subsequent investigation had revealed that sales commitments reported by Michaels and recorded by NSMC as accrued revenue for fiscal 1968 in fact never had existed. After confirming this report with NSMC's

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permitted the company to use the method. Petitioner concluded that his insistence upon non-recognition of income until all services were performed would have produced a distortion of the company's financial record, because the change in accounting methods would have presented NSMC as a failing company, even though substantial resources invested by the company had in fact produced favorable oral commitments. (Tr. 1505, 1837; Gx3, pp. 1913-1914)

president, petitioner concluded that the appropriate accounting treatment was a retroactive write-off of the amounts involved since revenues and expenses attributable to these "commitments" never would have been accrued had the truth been known. The fraudulent Michaels contracts represented $748,762 in accrued revenues for fiscal 1968 and $539,012 in accrued expenses—costs NSMC never would incur on these accounts—so that the net effect of the write-off on 1968 profits was to reduce the sum originally reported by $209,750 (Tr. 370-373, 661-664, 1853-1857.)

At about this same time, petitioner received advice from Mrs. Carol Raimondo, an accountant in PMM's tax department, that NSMC's 1968 income statement contained an unnecessary expense item of $190,000 charged to a deferred tax account.[4] While preparing NSMC's federal income tax return for the 1968 fiscal year, Mrs. Raimondo concluded that a tax loss carry forward, which apparently had not been foreseen at the time of the audit, would result in a tax saving for NSMC, making unnecessary the $190,000 charge on NSMC's books. (Tr. 1381-1390, Natelli Ex. O & P.) After conferring with Mrs. Raimondo's superior, who agreed with her conclusions, petitioner concluded that the deferred tax entry should be removed from NSMC's books. (Tr. 1858-1862.)

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[4] A deferred tax account is ordinarily included in a corporation's financial statement when, because of differences in tax and financial statement accounting methods, income reported in the financial statement exceeds that reportable for tax purposes. A charge to this account represents tax liability ultimately to be paid on income accrued for financial accounting purposes but not currently reported for tax purposes.

When NSMC sought assistance in making the necessary adjustments in the 1968 accounts, petitioner delegated to Scansaroli the preparation of appropriate entries. The entries Scansaroli prepared combined the write-off of the Michaels commitments with the write-off of the erroneous $190,000 charge to the deferred tax account, since these two components were nearly identical in amount and virtually cancelled one another in their effect upon NSMC's fiscal 1968 earnings. Scansaroli's initial entry, however, had not included one of the smaller Michaels commitments involving profits of $21,000, an omission that made the contract figure match almost exactly the amount of the tax item. When informed of this omission, petitioner insisted that this contract also be written off retroactively, and an appropriate entry to this effect was later made in NSMC's books.[5] (Tr. 1863-1867.)

D. Preparation of the September 1969 Proxy Statement And the Statements Alleged To Be False and Misleading

During the period from November 1968 to May 1969, NSMC had been engaged in an active program of acquiring other companies whose products had special appeal in the youth market. During the spring of 1969,

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[5]The court of appeals stated that in making the entry Scansaroli had used "the device of rounding off the tax item to make it conform exactly to the write-off." App. 9a. This characterization simply ignores petitioner's insistence upon correction of Scansaroli's entries as soon as he learned of the $21,000 omission.

NSMC's officers decided to call a stockholder's meeting in order to authorize the issuance of additional shares needed for completion of NSMC's acquisitions. The lengthy proxy statement for this meeting was to include NSMC's financial statement for the 1968 fiscal year ending August 31, 1968—the latest audited period—and an *unaudited* summary of earnings for the nine-month period from September 1, 1968 through May 31, 1969. The two distinct statements alleged by the indictment to be false and misleading were contained in those two portions of the proxy statement.

1. The Footnote to the Audited Statement of Earnings.

The audited statement of earnings printed in the proxy statement consisted of republished income statements for the preceding fiscal years 1966, 1967, and 1968. NSMC had acquired several companies subsequent to the close of the last period, however, and therefore the statements could not be republished in original form. Statement on Auditing Procedure No. 40 issued by the American Institute of Certified Public Accountants (AICPA) in October 1968 required that any republication of financial statements for pre-acquisition periods reflect the combined operations of NSMC and the acquired companies, as if they had been operating as an integral unit during those periods.[6] The retroactive "pooling" of

[6]The purpose of such a presentation is to make figures for pre- and post-acquisition periods properly comparable, by eliminating the sudden distortion that an acquisition would otherwise introduce into a financial statement. *See* AICPA, Reports Following a Pooling of Interests ¶1 (Statement on Auditing Procedure No. 40, 1968).

NSMC's earnings during pre-acquisition periods with those of its newly-acquired companies resulted in a substantial augmentation of the figures originally reported for those periods. For example, NSMC was reporting in the proxy statement sales and earnings for fiscal year 1968 of $11,541,895 and $773,152, respectively, whereas in its audited statement originally prepared for that year it had reported only $4,989,446 and $338,081, respectively. (Compare Gx. 5 and Gx. 25.) The republished statement for fiscal year 1968 reflected the write-off of the Michaels contracts and the elimination of the deferred tax provision, which was shown separately as an extraordinary credit.

Opinion No. 10 of the Accounting Principles Board of AICPA, then in effect, suggested that in order to show effects of pooling upon earnings trends, the acquiring company "may wish to provide reconciliations of amounts of revenues and earnings previously reported with those currently presented." Petitioner determined early in the course of preparing the financial statement that such a reconciliation, suggested but not required by then authoritative AICPA principles, should be included. A footnote to the audited statement of earnings contained, for both sales and earnings in each pre-acquisition period, a line labelled "originally reported" to show the figure attributable to NSMC as it existed before acquisitions, and a separate line labelled "pooled companies reflected retroactively" to show the addition of data for acquired companies. The sum of entires on the two separate lines equalled the corresponding entry in the financial statement presented in the main text. (Gx.5, p. 23)

As originally drafted by petitioner, the footnote contained an additional line labelled "retroactive adjustment for contract losses," in which petitioner planned to show the write-off of commitments fraudulently reported by Michaels. After reviewing the first printed draft of the proxy statement, which contained this line entry, petitioner determined that such an entry would have to be amplified by narrative discussion. As he attempted to draft an explanation of Michaels' misconduct, petitioner became concerned about the propriety of printing such allegations in a public document and began to question whether separate disclosure of retroactive adjustments to 1968 figures—the write-off of Michaels contracts and of the deferred tax expense—was really necessary at all, since their net effect was a reduction of only $21,000 from originally reported earnings of $388,000 (Tr. 1905-1908.)

Petitioner decided to discuss the matter with Leon Otkiss, a PMM partner who because of his technical proficiency was designated as an "SEC reviewing partner." In his discussion with Otkiss, petitioner questioned the need for separate treatment and narrative discussion of these two adjustments because of the small net effect these items had upon earnings. Petitioner mentioned the improvements in the company's record-keeping practices since the date of the original financial statement and noted that insistence on written commitments should eliminate problems such as the write-off of oral commitments that Michaels had reported. Otkiss agreed with petitioner that in these circumstances the post-period

adjustments had no material impact upon net income and that footnote discussion of the contract write-offs was therefore not necessary.[7] As a result the "adjustment for contract losses" line in the footnote petitioner had drafted was eliminated, and the adjustments for the contract write-offs and the deferred tax provision were simply reflected in the footnote in the figures entered in the line labelled "pooled companies reflected retroactively." (Tr. 1741-1752, 1908-1910.)

The indictment charged that the inclusion of these adjustments in the "pooled companies" line without seperate disclosure constituted a materially false statement in violation of Section 32(a) of the Act, 15 U.S.C. § 78ff(a).

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[7]The court of appeals, without citing any support in the record, stated that petitioner had sought Otkiss' advice "without full disclosure to Otkiss of all relevant factors." (App. 17a.) This characterization is inconsistent with testimony by Otkiss that *he* asked all questions he thought relevant and that petitioner answered them openly. (Tr. 1771.) On cross-examination Otkiss testified that he "had no recollection" of petitioner's telling him about matters relating to the unaudited statement concerning a later period, discussed *infra* pp. 15-19. (Tr. 1767-1770.) These matters had nothing to do with the footnote to the audited statement on which petitioner sought Otkiss' advice. This testimony, therefore, fails to support the insinuation that petitioner had concealed from his partner any information necessary to make a judgment on the necessity of footnote disclosure or on the propriety of percentage-of-completion accounting, the two matters on which petitioner sought Otkiss' assistance.

2. The Unaudited Statement of Earnings.

The other specification of material falsity related to the inclusion of income from a promotion contract in figures appearing in an *unaudited* financial statement for the nine-month period ending May 31, 1969. PMM had not performed an audit with respect to the nine-month figures and these were clearly labelled "unaudited" in the proxy statement. Because those figures would appear in proxy material also containing figures PMM had audited, however, petitioner had a professional obligation to object to any known departures from accepted accounting principles.

Among the items included in the nine-month statement as initially drafted by NSMC's management was a commitment from Pontiac Division of General Motors Corporation involving gross revenue of $1.2 million. The Pontiac commitment originally had been included by NSMC in an unaudited statement of earnings for the first six months of fiscal 1969, published by NSMC in May 1969. Although petitioner was in no way associated with this statement, when he became aware of the entry he advised NSMC's management that the accrual of revenue on this commitment would not be accepted at the time of the fiscal 1969 audit because the supporting letter from Pontiac Division was not in the legally-binding form prescribed by NSMC's general counsel after the December 1968 meeting.[8]

During the course of work on the proxy statement, petitioner went from his office in the District of Columbia to New York City to spend the evening of

[8] *See* p. 8, *supra.*

August 14 reviewing the proxy statement at the offices of NSMC's printer. At that time he insisted upon changes in the figures already set in type to reflect deletion of the Pontiac commitment. NSMC's president Cortes Randell, who was present at the printer's plant, insisted that the Pontiac commitment was firm and offered to fly petitioner to Detroit to meet the Pontiac official involved. Petitioner declined this offer and maintained his prior position that while there was no reason to question the genuineness of the letter, the commitment should not be included in the figures because it was not in the legally binding form prescribed by the company's counsel. (Tr. 515-519, 530-532, 651-653, 672-673, 1913-1919; Gx. 12; Natelli Ex. G.)

At some point during this session, which stretched into the early morning hours of August 15, Randell reminded petitioner of an oral commitment Eastern Airlines had given in May, for which written confirmation had recently been received. Randell suggested that since the two contracts were approximately equal and Eastern's had not been reflected in the figures contained in the printed draft, the Eastern commitment, now confirmed in writing, should be "substituted" for the Pontiac commitment, averting the need to change any of the figures set in type. Despite the unusual hour, Randell arranged for an NSMC account executive to telephone the gross sales and costs anticipated on the Eastern contract. Those figures indicated, however, that NSMC's expected earnings on the Eastern contract were about $200,000 less than those anticipated on the Pontiac commitment. Petitioner concluded that in no event could the figures currently in the draft proxy statement remain unchanged. His decision meant that the entire nine-month statement had to be reprinted.

Before his departure from the printer, petitioner was asked to consider whether, when the statement was revised, the company could include the Eastern contract, since the Eastern letter, in the agreed-upon form, confirmed an oral commitment made in May, during the period covered by the unaudited statement. During the day of August 15, Dennis Kelly, an NSMC vice-president, brought petitioner a copy of the letter signed by the Eastern Airlines Manager of Special Markets, which read in pertinent part:

> This is to confirm our verbal commitment given to you on May 14, 1969.
>
> We will accept and utilize during the fiscal year 1970, an amount of not less than $820,000 for National Student Marketing Corporation's services as offered to us in your proposal originally submitted on May 7, 1969. (Gx 18.)

Kelly also produced a copy of the proposal referred to in the Eastern letter and reviewed with petitioner the costs allocable to the Eastern program. Petitioner left New York on August 15 without having decided whether inclusion of the Eastern contract would be proper. (Tr. 539-544, 677-679, 1919-1928.)

During the following week, petitioner reviewed the time sheets of Robert Bushnell, the NSMC account executive having primary responsibility for the Eastern Airlines account; the records showed that he had spent more than 110 hours on the Eastern program prior to the end of May. Petitioner concluded that accrual of some revenue on the Eastern contract in the unaudited statement would be consistent with percentage-of-completion accounting treatment and accordingly advised NSMC that he would not object to the proposed inclusion. When the unaudited statement was

reprinted to delete revenue attributable to the Pontiac commitment and include that attributable to the Eastern account, the nine-month sales and earnings were $400,000 and $200,000 lower, respectively, than the figures that had appeared in the earlier printed draft, to which petitioner had objected.[9] (Tr. 541-544, 680-682, 769-770, 1925-1930; Natelli Ex. J; Gx. 13, p. 2666.)

The indictment alleged that the unaudited nine-month statement had falsely overstated NSMC's sales and earnings. The principal component of the overstatement was said to be the Eastern contract. This was described by government counsel at trial as a "complete phony,"

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[9]The key passage in the opinion of the court below on petitioner's alleged mishandling of the Eastern commitment (App. 15a) contains several mistakes about the record. First, the court's view that the Eastern commitment was "substituted" for the Pontiac contract is erroneous because the initial figures that reflected the Pontiac contract were not allowed to stand. While that was the treatment proposed by NSMC's president Randell, the suggestion was rejected by petitioner, and the proxy statement was reprinted with new computations. It was Randell's suggestion to disregard the differences in the figures that petitioner described as "weird," not the Eastern commitment itself as suggested by the court. Notwithstanding the court's characterization of the two commitments as "strangely close in amount," the Eastern contract on its face showed $227,000 less in earnings for NSMC than had the Pontiac commitment, a difference that necessitated reprinting of the proxy statement to show those lower earnings.

Next, the court's observation that NSMC had "only time logs" but no expenditures and no billing on the program is without significance, since the essence of percentage-of-completion accounting is the accrual of revenue and costs on unbilled sales. Finally, the court's remark that petitioner had seen "not one scrap of paper" from Eastern other than the commitment letter simply ignores the character of the letter itself, which on its face was a binding document in the form approved by counsel.

which appeared "[b]y magic [at] 3 o'clock in the morning." (Tr. 2295.) Significantly, the government never offered any evidence that the Eastern letter examined by petitioner was anything other than what it purported to be—a binding commitment by Eastern to purchase at least $820,000 of NSMC's services—and, indeed, testimony by the principal government witness in a subsequent, related prosecution showed that the prosecutor had substantially (and apparently knowingly) misrepresented the facts in his presentations to the jury trying petitioner.[10]

E. The Trial and the Instructions to the Jury

The key issues for the jury were whether petitioner had made any false material statements to the SEC, and, if so, whether he had done so "willfully" and "knowingly." With respect to the omission of footnote discussion of the retroactive write-off of the Michaels contracts, petitioner's position was that (1) the contract write-off and the correction of the deferred tax charge

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[10]The subsequent testimony and its significance are examined *infra*, pp. 39-45. What is important here is that the government failed to show that the Eastern contract was a fraud—an essential element to sustain this specification. The court below never acknowledged this omission in the government's proof but confined itself to stating that the Eastern contract "was a matter for deep suspicion." (App. 15a.) While we believe this characterization erroneous for the reasons stated in n.9, *supra*, the court's remark shows, at most, that petitioner should have questioned the Eastern contract, not that it was not genuine or that its inclusion rendered the unaudited financial statement false and misleading.

had only a small net effect upon NSMC's 1968 earnings when combined, (2) the retroactive write-off itself seemed traceable to dishonesty of an employee who already had been discharged, and (3) new procedures for obtaining written commitments in binding form seemed likely to prevent recurrence of the situation. Petitioner and Otkiss testified that in these circumstances they believed in good faith that omission of further explanation of the adjustments in the pooled financial statement for fiscal year 1968 was not material. With regard to the Eastern contract that the government described as a "phony," petitioner's position was that whether or not the contract was actually bogus--a point on which the government offered no evidence--he had believed the Eastern contract to be genuine and had no reason to seek verification from the Eastern official who signed the letter, since the financial statement in question was not the subject of an audit, and the letter was in the legally binding form that he would require at the time of the next audit.

The trial judge instructed the jury that a conviction could be returned without a finding that petitioner *knew* of any material inaccuracy in the figures. The court stated that, although "ordinary or simple negligence or mistake alone would be insufficient to support a finding of guilty knowledge or willfulness or intent," the jury could convict if it found "reckless deliberate indifference to or disregard for truth or falsity." (Tr. 2365.) Defense counsel objected to the "recklessness" element of the charge (Tr. 2139-2140, 2427-2429), as well as to the court's failure to explain an independent accountant's duty with respect to an unaudited statement. Notwithstanding the fact that an *unaudited* statement formed the basis of the second specification, and that the court instructed the jury on the outside accountant's duties when conducting an *audit*, the court refused to distinguish that duty from an accountant's professional

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obligations with respect to *unaudited* financial statements. (Tr. 2365-2369, 2384.) The Court's instructions on "willful" and "knowing" conduct, and specifically the "recklessness" concept, were discernibly the basis for the jury's verdict.[11]

REASONS FOR GRANTING THE WRIT

Introduction and Summary

This case is part of extensive litigation that has been described by one court as a "turning point" in the exposure of accountants and lawyers to liability under the securities laws.[12] In this "test" prosecution, the government urged that petitioner could be convicted of

[11] After an initial period of deliberation, the jury requested further instruction on the element of "knowing" and "willful" conduct. In his supplementary instructions, the judge told the jury that a conviction was permissible only if petitioner "knew that a portion of the financial statement . . . was false or misleading" and if he had the "intention to include false or misleading information of a material nature. . . ." (Tr. 2400.) This time, however, the court omitted any reference to recklessness as a basis for conviction, despite objection from the government. (Tr. 2401.) After another period of deliberations, the jury reported itself deadlocked. (Tr. 2420.)

When the judge instructed the jury to continue deliberations, the foreman asked him to define "knowingly" again. On this occasion the supplementary charge reintroduced "recklessness" as an adequate basis for conviction, without actual knowledge of material falsity. (Tr. 2426-2428.) After receiving these instructions, the jury brought in a verdict of guilty.

[12] *See SEC v. National Student Marketing Corp.*, CCH Fed. Sec. L. Rep. ¶95,331, n.32 (D. D.C. Oct. 21, 1975), the civil action brought by the SEC against officers and directors of NSMC, NSMC's independent accountants, outside attorneys retained by NSMC, and attorneys serving certain parties with which NSMC transacted business.

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"knowingly" and "willfully" filing false financial statements because his purported failure to satisfy what the government contended were his professional obligations constituted "reckless disregard" of the truth. The court below, in affirming the conviction, concluded that petitioner had "willfully" and "knowingly" filed a materially false statement with the SEC by failing to perform "a specific duty to discover the true facts." (App. 22a.) Yet the specific duty the court discerned is not found in any pronouncement of the accounting profession, and the court disregarded a distinction the profession has long recognized as significant—the difference between an independent accountant's *auditing* function and his simple association with *unaudited* financial presentations. Although the court based its affirmance of the conviction upon petitioner's failure to investigate an unaudited financial statement, it approved the jury instructions that dealt exclusively with the auditing function. The court concluded that an accountant's conduct should be measured by jurors' "common understanding" of proper conduct. (App. 24a.)

The decision below also constitutes a novel expansion of the statutory requirement of culpable knowledge—an expansion expressly tied to petitioner's status as a member of one of the "ancient professions [law and accounting]." (App. 21a.) The court concluded that because petitioner had failed to satisfy the obligation of affirmative inquiry created by the court, he could be held to have "willfully" and "knowingly" filed a materially false statement without regard to his actual knowledge or belief. It was sufficient, the court held, if petitioner had acted with "reckless disregard" for the true facts; this was equated with foreknowledge of falsity even without

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the accompanying finding, until now universally required in the case of a prohibition of "knowing" and "willful" conduct, that the defendant has acted with at least a *conscious purpose* to remain ignorant. Thus, by coupling its erroneous determination of an accountant's professional responsibilities with its elimination of the requirement of scienter, the court below upheld a conviction despite the district judge's appraisal that petitioner did not have the requisite intent. The judge stated at sentencing:

> . . . I think *you are absolutely sincere when you say that you do not believe that you did anything wrong* in this audit or audits for National Student Marketing. After thinking about the matter for a long time I think you honestly mean that. But the tragedy is that the jury found that this was an *audit or audits done with reckless disregard for what was really involved.* We know that because of the record showing what it did in the jury deliberation. (S. Tr. 12) (Emphasis added.)[13]

The decision to hold accountants, under threat of criminal prosecution, to virtually the same duty of verification in connection with unaudited financial statements that heretofore has been applied only when accountants certify financial data, is one that obviously

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[13]A sentence of one year in prison plus a $10,000 fine was imposed, with all but sixty days of the prison sentence suspended. Despite the fact that the trial judged acknowledged that in 13 years as a trial judge he had not dealt with any person "more generally reputable, and deservedly so," than petitioner (S. Tr. 12), the judge stated he was imposing a prison sentence "because I think the profession of accountancy has failed just as badly as some aspects of the legal profession have failed in understanding their professional responsibility." (*Id.*)

will have broad impact upon the accounting profession. The abandonment of authoritative professional pronouncements in favor of the "common understanding" of lay jurors as the standard for measuring an accountant's conduct is a matter that warrants considered review by this Court. The decision below takes on added significance because the vehicle for enhanced discipline of professionals is a criminal statute, and the discipline has been imposed by a weakening of the requirement of a culpable state of mind. The determination of the degree of *mens rea* necessary to support criminal conviction under regulatory statutes has long been regarded as a judgment for this Court to make.[14] This case is one of special significance because the court below has carved from a statute of general applicability a special exception to the *mens rea* requirement applicable only to professionals.

A grant of certiorari is particularly appropriate because the Court has before it *Ernst & Ernst v. Hochfelder*, No. 75-1042, in which the Court is asked to consider whether an accountant's negligence in preparing financial statements is sufficient to bring *civil* liability under the securities laws. However that question may be resolved, the Court should grant review in this case to reaffirm that only "knowing" falsehood warrants the imposition of criminal sanctions and that where statements are made in ignorance of true facts only a

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[14]*See e.g., United States v. Murdock*, 290 U.S. 389 (1933); *United States v. Balint*, 258 U.S. 250 (1922); *Sansone v. United States*, 380 U.S. 343 (1965); *United States v. International Minerals & Chemical Corp.*, 402 U.S. 558 (1971); *United States v. Bishop*, 412 U.S. 346 (1973); *Feola v. United States* ____ U.S. ____ (No. 73-1123, Mar. 19, 1975); *United States v. Park*, ____ U.S. ____ (No. 74-215, June 9, 1975).

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conscious purpose to avoid learning the truth can possibly justify treating the statements as the predicate for a *criminal* conviction.

This case also presents other issues of importance for the integrity of federal criminal justice. These involve the appellate court's approval of inadequate jury instructions on the constitutional requirement of unanimity, and the sustaining of venue in a district other than the one in which the allegedly false statement was required to be, and was, filed. Finally, events since the affirmance of this conviction by the court below strongly indicate that the government procured the conviction by misconduct; these developments are serious enough to warrant summary action by this Court.

I.

THE DECISION BELOW OBLITERATES THE WIDELY ACCEPTED PROFESSIONAL DISTINCTION BETWEEN AUDITED AND UNAUDITED FINANCIAL STATEMENTS.

The affirmance of petitioner's conviction is premised upon the court's conclusion that he "recklessly" defaulted on his alleged professional obligations by a failure to confirm the Eastern contract through communication with Eastern officials. (App. 22a-23a) This decision draws into question what has been the long held and widely accepted principle in the accounting profession that an accountant's responsibilities in dealing with unaudited figures are not as extensive as those relating to an audit. The Eastern contract appeared in what was clearly labelled as an *unaudited* presentation. The significance of this fact largely eluded the trial court, which

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instructed the jury on auditing but refused petitioner's requested instruction on the scope of an accountant's professional obligations when working with unaudited statements. The court of appeals affirmed the conviction notwithstanding the absence of *any* jury instruction distinguishing audited from unaudited statements; and in an opinion which confused the two kinds in explaining the professional standards established by AICPA, the court adopted a theory of professional obligation—the breach of which it held may carry criminal liability—that compels accountants to ignore the distinction.

When conducting an audit, the accountant is expected to go beyond company records, as, for example, by observing inventories or by communicating directly with customers of the audited company. *See* 1 CCH AICPA Professional Standards § 331. With respect to unaudited statements, however, the profession has recognized that the accountant's duty is more limited. The AICPA Standards, which govern the professional conduct of certified public accountants, flatly state that:

> The certified public accountant has no responsibility to apply any auditing procedures to unaudited financial statements. 1 CCH §516.02.

When an accountant becomes "associated" with an unaudited financial presentation,[15] AICPA Standards prescribe his obligations as follows:

> [I]f the certified public accountant concludes on the basis of facts known to him that unaudited

[15] An accountant becomes "associated" with unaudited presentations if he assists in their preparation, or if he permits his name to be used elsewhere in a document containing them. 1 CCH §§516.03, 516.11, & 516.12.

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> financial statements with which he may become associated are *not in conformity to generally accepted principles,* which include adequate disclosure, he should insist . . . upon appropriate revision. . . . §516.06 [emphasis added].

The SEC Accounting Rules themselves distinguish audited and unaudited statements and provide that with respect to unaudited data an accountant must follow "appropriate professional standards." SEC Reg. 210.2-02(e) *as amended,* 4 CCH Fed. Sec. L. Rep. ¶69,128A (1975). In the case of NSMC's unaudited nine-month statement petitioner assured himself that the company's records supported accrual of the income included, consistent with percentage-of-completion accounting principles. He refused to permit recognition of income on the Pontiac commitment because the letter supporting that commitment was not in legally binding form. But the Eastern contract was acceptable because the supporting letter evidencing that commitment was in the legally binding form prescribed by NSMC's counsel.

In affirming this conviction, the court below concluded, citing the AICPA Standards, that petitioner had failed to satisfy professional obligations by his failure to take the additional step of communicating with Eastern. (App. 16a-17a.) But, as demonstrated, nothing in the "generally accepted principles" applicable to unaudited statements required petitioner to verify the genuineness of company records that were in the proper form.[16]

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[16] Since the court of appeals relied heavily upon that specification regarding the Eastern contract, we reiterate that the Government introduced no evidence to show that the Eastern contract was not genuine. Furthermore, if petitioner had done what the court found he had crucially failed to do—communicate with Eastern about the commitment—he would not have discovered any defect in the apparently binding contract. See pp. 39-45 *infra.*

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The court below not only misinterpreted existing pronouncements of the profession, but abandoned them entirely by approving jury instructions that focused exclusively on auditing and failed to differentiate the accountant's more limited responsibility in connection with unaudited presentations.[17] Ultimately, the court concluded, petitioner's conduct was to be judged according to the "common understanding" of the jury about what constitutes legitimate behavior for a professional accountant.

Quite apart from the unfairness of convicting an accountant found to have violated this "common understanding" by actions that conformed to authoritative professional standards at the time he acted, the prospective impact of this decision upon accounting practice will be substantial and adverse. Faced with the court's vague standard of conduct enforced by criminal sanction, a professional accountant must observe auditing procedures even when dealing with unaudited statements. The result, however, will be a loss of the benefits unaudited statements provide for the financial community.

Companies publishing audited financial statements often include unaudited "interim statements" summa-

[17]The court of appeals concluded that the instruction requested by petitioner was not proper. (App. 24a.) Any deficiency in the proffered instruction, however, did not justify the trial court's refusal, after instructing the jury on an *auditor's* responsibility, to add *any* remarks distinguishing *unaudited* statements. This omission was specifically noted by defense counsel in compliance with Fed.R.Cr.P.30. (Tr. 2384.)

The distinction between audited and unaudited presentations has been applied in civil suits against accountants in the district courts, *see, e.g., Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967); *Gold v. DCL Inc.*, 1973 CCH Fed. Sec. L. Rep. ¶94,036 (S.D.N.Y. 1973), but the decision below dealing with criminal liability casts doubt upon whether the distinction will continue to receive judicial recognition.

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rizing the company's earnings record from the close of the audited period to the date of publication. Because adherence to auditing procedures often means that the audited statements must follow by several months the close of the audited period, these unaudited interim statements are viewed as helpful to investors, even without an auditor's certification, since they make more current the picture of the firm's financial status. Indeed, the SEC has moved to expand the inclusion of interim financial data in annual financial statements filed with it. *See* Accounting Series Release No. 177, 5 CCH Fed. Sec. L. Rep. ¶72,199 (September 10, 1975). Interim statements cannot, however, serve the function of making audited statements more current if accountants must follow full audit procedures or suffer criminal liability for what later may be found to have been a "reckless" failure to seek additional information concerning an unaudited presentation.

If Section 32(a) of the Securities Exchange Act compels accountants, despite general professional practice, to treat all associations with financial presentations as demanding the same degree of involvement and scrutiny—or to risk conviction of a federal felony—such a departure from accepted accounting practice that is as old as the statute itself should be mandated uniformly and authoritatively by this Court.

II.

THE COURT OF APPEALS HAS WEAKENED THE REQUIREMENT OF SCIENTER ASSOCIATED WITH THE PROSCRIPTION OF "KNOWING" AND "WILLFUL" CONDUCT.

The court below concluded that because petitioner had failed to perform a duty to inquire further into the Eastern contract, he had acted with "reckless indifference" to the true facts, and that this amounted to "knowing" and "willful" false statement of material facts. Even if the court's initial premise that petitioner had an obligation to inquire further is accepted—a position untenable unless one rejects the generally accepted professional standards prevailing prior to the decision below—it is plain that the court's conclusion involves a novel departure from the usual concepts of criminal culpability.

In Section 32(a) of the Securities Exchange Act, Congress has sought to criminalize only "knowing" and "willful" falsehood; the making of an erroneous statement in ignorance of the facts can be held criminal only if the defendant has consciously closed his eyes to the truth. As the Third Circuit has noted, "[o]nly a finding of a *conscious purpose* to avoid enlightenment will justify charging the defendant with knowledge." *United States v. General Motors Corp.*, 226 F.2d 745, 749 (3d Cir. 1955). A conscious, purposeful refusal to recognize the truth may lay the foundation for a finding that the accused really did know, *see United States v. Jewell*, ____ F.2d ____ (9th Cir. No. 74-2832, Feb. 26, 1975), or it may permit the conclusion that he "de-

liberately chose not to learn for the very purpose of being able to assert his ignorance if discovered," *United States v. Olivares-Vega*, 495 F.2d 827, 830 n.10 (2d Cir. 1974). In either case, the finding of a conscious purpose to avoid learning the truth is necessary to establish that the defendant acted with the consciousness of wrongdoing which the elements "knowingly" and "willfully" require.[18] *Morisette v. United States* 342 U.S. 246, 264-65 (1952); compare *United States v. Park*, _____ U.S. _____ (No. 74-215, June 9, 1975). Only recently, indeed, a different panel of the same court that affirmed petitioner's conviction reversed the conviction of a defendant charged

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[18]Other federal statutes proscribing "knowing" and "willful" conduct have been so construed by the courts of appeals. *E.g.*, 21 U.S.C. §960(a), knowingly violating narcotics control laws, *see United States v. Zapata*, 497 F.2d 95, 97 n.5 (5th Cir. 1974); *United States v. Joly*, 493 F.2d 672, 674-675 (2d Cir. 1974); *Verdugo v. United States*, 402 F.2d 599, 604 (9th Cir. 1968) *cert. denied* 402 U.S. 961 (1971); *Griego v. United States*, 298 F.2d 845, 849 (10th Cir. 1956).

18 U.S.C. §922(a)(6), knowingly making false statements in connection with acquisition of a firearm, *see United States v. Thomas*, 484 F.2d 909 (6th Cir. 1973), *cert. denied* 415 U.S. 924 (1973); *United States v. Squires*, 440 F.2d 859, 864 n.12 (2d Cir. 1971).

18 U.S.C. §1001, knowingly making false statements in a matter before a federal department or agency, *see United States v. Sarantos*, 455 F.2d 877 (2d Cir. 1972); *United States v. Clearfield*, 358 F. Supp. 564 (E.D. Pa. 1973).

18 U.S.C. §2314, knowing transportation of stolen property, *see United States v. Brawer*, 482 F.2d 117, 128 n.14 (2d Cir. 1973); *United States v. Jacobs*, 472 F.2d 270, 287 & n.37 (2d Cir.), *cert. denied* 414 U.S. 821 (1973).

See also United States v. Ottley, 509 F.2d 667, 672-673 (2d Cir. 1975) (willful violation of fiduciary duty imposed by

with knowing possession of stolen mail matter, 18 U.S.C. § 1708, because of the trial judge's failure to include the requirement of a "conscious purpose" when instructing that a "reckless disregard" for the truth would suffice to convict. *United States v. Bright*, 517 F.2d 584 (2d Cir. 1975).

In this case, however, according to the decision below, petitioner's status as a professional accountant caused the requirement of conscious purpose to vanish. This construction of Section 32(a), which the court made no pretense of supporting by the language or legislative history of the statute, introduces a serious distortion in federal prosecutions of "knowing" and "willful" conduct. While a citizen who obtains goods under circumstances indicating a high probability that they are stolen but remains ignorant of their true character may be convicted only upon a finding that he acted with a conscious purpose to avoid learning the truth, a professional accountant will more readily suffer a felony conviction if a jury later concludes that he was confronted with suspicious figures.[19] Congress, however,

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LMRDA, 29 U.S.C. §439(a)); *Walters v. United States*, 256 F.2d 840 (9th Cir.) *cert. denied* 358 U.S. 833 (1958) (willful violation of Securities Act of 1933, 15 U.S.C. §77x); *Forster v. United States*, 237 F.2d 617, 620-621 (9th Cir. 1956) (willful and knowing evasion of income tax, § 145(b) of Internal Revenue Code of 1939).

[19] Indeed, the decision below causes a further distortion in that professionals will be more readily subject to criminal sanction than the businessmen who retain them. The indicted officers of NSMC, had they gone to trial, would have been entitled to instructions stating that "knowing" conduct consists at least of *conscious* disregard of the truth. The ample evidence available from related litigation, showing that NSMC's officers

has done nothing that would justify such a novel and discriminatory application of Section 32(a), and it is not for the courts to change the statutory standard of criminal liability in order to impose upon professionals a higher standard of care.

III.

THIS CASE PRESENTS AN IMPORTANT ISSUE OF SOUND JUDICIAL ADMINISTRATION TO ASSURE UNANIMOUS VERDICTS.

The indictment contained, in a single count, two distinct specifications against petitioner, one involving the footnote to the audited statement of earnings and the other concerning the Eastern contract reflected in the unaudited statement for a later period. The trial judge charged the jury that it could convict upon finding that the proxy statement was false in either respect charged. Defense counsel asked the court to advise the jurors that they must be unanimous as to *which* of the two specifications, if either, established a violation of the statute. This request was refused.[20]

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were engaged in a variety of fraudulent conduct with the objective of deceiving the accountants, demonstrates the impropriety—and the injustice—of subjecting petitioner to a harsher standard of criminal responsibility.

[20]The trial judge charged that "if you find that the proxy statement was false in either one of these two respects, that is sufficient to support a conviction." (Tr. 2340.) Much later in the charge, the judge included the general admonition that the "verdict" had to be unanimous. (Tr. 2380.)

The failure of the trial court to give the requested charge created a substantial risk that the requirement of unanimity was not satisfied; the jurors might have agreed that the government had proved *one* specification of the indictment beyond a reasonable doubt, but disagreed as to which. This risk is particularly acute because of the state of the evidence, which even the court below found at most marginally sufficient. The court of appeals acknowledged that it would have been "sound practice" to instruct the jury as petitioner had requested, but was nevertheless content to assume that a general admonition that the "verdict" must be unanimous "suffices to instruct the jury that they must be unanimous on whatever specifications they find to be the predicate of the guilty verdict." (App. 26a-27a)

Unanimity of jury verdicts in federal prosecutions is compelled by the Sixth Amendment and is specifically commanded by Rule 31(a) of the Federal Rules of Criminal Procedure. See *Johnson v. Louisiana*, 406 U.S. 356, 369-371, (Powell, J.), 382-384 (Douglas, J.), 395 (Brennan, J.), 397-399 (Stewart, J.), 400-401 (Marshall, J.) (1972). The requirement of unanimity "extends to all issues—character or degree of the crime, guilt and punishment—which are left to the jury." *Andres v. United States*, 333 U.S. 740, 748 (1948).

This constitutional requirement was substantially diluted in the present case, for the meaning of the requirement as it affects the jury's decision-making process was not explained. Where the government's several factual theories are embodied in separate counts of an indictment, the necessity of delivering a separate verdict on each count insures that the jurors agree on each evidentiary path to conviction. The indictment in this case offered no such protection, since two specifications were contained in the same count. Moreover,

because the two specifications did not relate to the same statement alleged to be false – one concerned an audited presentation, the other an unaudited statement for a different period – there was no assurance that a juror's finding with respect to one specification implied a similar finding on the other.

In these circumstances, when the jury was told that the government need prove only one specification to prevail, the trial judge's admonition that "your verdict must be unanimous" was insufficient. It directed the jury's attention to unanimity of *result*, but simply failed to explain that unanimity means agreement about the basic facts on which the ultimate conclusion is grounded.

The requirement of unanimity in federal criminal verdicts is too important to become merely a symbol, whose specific meaning for the jury's deliberations is left undefined. This Court should grant review in order to establish a uniform principle for the effective implementation of the unanimity requirement of the Sixth Amendment and Federal Criminal Rule 31(a).

IV.

BY EXPRESSLY CONFINING "TO THE FACTS" THIS COURT'S DECISION IN *TRAVIS v. UNITED STATES*, 364 U.S. 631 (1964), AND IN SUSTAINING VENUE THE COURT OF APPEALS OVERSTEPPED ITS BOUNDS AND CREATED AN INTER-CIRCUIT CONFLICT ON THE PROPER INTERPRETATION OF *TRAVIS*.

Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa, provides that criminal proceedings

involving alleged violations of the Act are to be brought in the district where "any act or transaction *constituting the violation* occurred" [emphasis added]. The indictment, tracking the language of Section 32(a), 15 U.S.C. §78ff(a), charged petitioner with having made materially false statements in a proxy statement "required to be filed" with the SEC. While it is undisputed that the statement was filed with the SEC at its offices in Washington, D.C. (where petitioner had his office as well), the prosecution was brought in the Southern District of New York, where certain steps in the preparation of the proxy statement occurred. But the offense charged had occurred, if at all, where the statement was filed with the SEC, and the act "constituting the violation" of Section 32(a) occurred at the SEC's offices in Washington. Petitioner, therefore, moved the trial court to dismiss on the ground that under Section 27 venue properly lay only in the District of Columbia. The trial judge denied the motion, and the court of appeals affirmed.

While this Court has never construed the venue provisions of Section 27, it has had occasion to consider the situs of an offense analogous to the one with which petitioner was charged. In *Travis v. United States*, 364 U.S. 631 (1964), this Court considered the proper venue for a prosecution under a similar statute, the False Statements Act, 18 U.S.C. §1001, which punishes the making of a false statement "in any matter within the jurisdiction of any department or agency of the United States." The statement there was an affidavit of non-Communist affiliation, prepared in Colorado and filed with the National Labor Relations Board in

Washington, D.C. pursuant to then section 9(h) of the National Labor Relations Act, which provided that the Board could not investigate any complaint filed by a union "unless there is on file with the Board" such an affidavit from each union officer. Emphasizing that the underlying regulatory statute, section 9(h), did not itself require the filing of a statement but simply conditioned Board action upon its having been filed, this Court held that there would be no violation of the False Statements Act until the allegedly offending affidavit was actually filed with the Board and, accordingly, that venue for such an offense lay only in the District of Columbia, where the filing had occurred.

The *Travis* holding clearly controls the instant prosecution. Like the filing of the affidavit in *Travis*, the submission of NSMC's proxy statement to the SEC was only required indirectly. While there is no affirmative obligation to file a proxy statement with the Commission, proxies may not lawfully be solicited until a statement is on file. Securities Exchange Act, Section 14(a), 15 U.S.C. § 78n(a); SEC Reg. 240.14a-6. As in *Travis*, any false statement was made, if at all, when the document containing it was filed, and the place of filing then fixed the venue for prosecution.

In refusing to follow the plain command of *Travis*, the court of appeals expressed the view that that decision was "surely meant to be confined to the facts based upon the unusual statute involved."[21] (App. 30a.) The

[21]Purporting to distinguish *Travis*, the court of appeals observed that while the filing of the union affidavit was a jurisdictional prerequisite for certain NLRB action, the filing of a proxy statement is "part of the continuous process of the

principles of *Travis* have been respected by other courts, however. Only recently a decision of the Court of Appeals for the District of Columbia Circuit construed Section 27 of the Securities Exchange Act in line with *Travis* in determining proper venue for a civil suit brought by the SEC. *See Investors Funding Corp. v. Jones*, 495 F.2d 1000, 1001-1003 (D.C. Cir. 1974).[22] Insofar as the decision below limits *Travis* to its facts, it is in conflict with that decision of another circuit. A determination that a decision of this Court should be confined to its

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solicitation of proxies." (App. 30a) These remarks have no analytical significance. Petitioner was not charged under the provisions of the securities laws forbidding the making of false or misleading statements to investors, *e.g.* 15 U.S.C. §77q, or unlawful solicitation of proxies, 15 U.S.C. §78n, but with making a false statement in a document "required to be filed" with the SEC. The provisions of §32(a) charged here are concerned with the accuracy of information filed with a government agency and are clearly comparable to the provisions involved in *Travis*.

The court of appeals also considered it "paradoxical" that petitioner is pressing for venue in the District of Columbia when other defendants, not living and working in Washington, would rather be tried in "their home districts" (App. 30a, n.17). The venue question here pertains to a relatively distinct class of "false filing" charges, and if a defendant considers the District of Columbia an unfavorable forum he can either waive any objection to bringing an indictment elsewhere or seek a change of venue out of the District of Columbia pursuant to Rule 21(b) of the Federal Rules of Criminal Procedure.

[22] *Investors Funding* held that in light of *Travis* and *United States v. Lombardo*, 241 U.S. 73 (1916), a civil action alleging late filing of reports to the SEC required by Sections 13(a) and 15(d) of the Securities Exchange Act, 15 U.S.C. §§78m(a) and 78o(d), could be brought in the District of Columbia. While the lawsuit was civil in nature, the court was construing and applying the same language in the venue provision of the Act, Section 27, that governs the instant prosecution.

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facts ought not to be usurped by a lower court. Review by this Court is especially urgent now that two courts of appeals have disagreed as to whether *Travis* has application to securities act violations.

V.

PETITIONER WAS DEPRIVED OF A FAIR TRIAL WHEN THE GOVERNMENT WITHHELD CRUCIAL FACTS AND MADE AFFIRMATIVE MISREPRESENTATIONS TO THE JURY.

The government asserted throughout petitioner's trial that the Eastern commitment letter had been a fabrication devised by the participants in the August 14 meeting at NSMC's printer. For example, government counsel argued to the jury in summation:

> "If anything has been proved in this case, ladies and gentlemen, the Government submits that you must have been satisfied beyond any doubt that that Eastern contract was known to be a complete phony when it came up.
>
> "The fact is this has to be one of the most cynical events that you will probably ever hear about, at 3 o'clock in the morning at the printers plant where they are printing up this very proxy statement, there's going to be a big hole in the earnings because the Pontiac contract has to come out.
>
> "By magic 3 o'clock in the morning the first time it is mentioned the Eastern Airlines contract comes up. It is supposed to be a contract for the period which ended two months before and yet in the two months between May and August nobody seems to

> have peeped a word [about] it to the controller of National Student Marketing or anybody else who had any business with this matter."[23]

Counsel's assertion that the existence of the Eastern commitment was fabricated that evening by the participants in the meeting has been directly contradicted by the government's own proof in a related prosecution brought only after petitioner's conviction was obtained. Less than a month after the jury found petitioner guilty, the government indicted Thomas Mullen, the Eastern Airlines executive who signed the commitment letter, charging him, *inter alia*, with conspiring with NSMC's officers to deceive NSMC's independent accountants. Cortes Randell, formerly NSMC's president, who had pleaded guilty prior to petitioner's trial but had not been called by the government to testify there, appeared as the principal government witness in Mullen's trial on October 14, 1975. There Randell testified that, sometime prior to the day on which they went to the printers, petitioner had told him that the Pontiac figures could not be included in the nine-month unaudited statement of earnings. Randell then explained:

> I then asked the account executives if any of them knew of other contracts which were pending which we could put on our books and Dennis Kelly said that–

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[23]Government counsel made comparable remarks in his opening statement, asserting that "[N]obody but nobody had mentioned this enormous sale, virtually the same size as the Pontiac contract, between May and August." (Tr. 56).

* * *

Q. What did Dennis Kelly say to you?

A. He said *he had been working on a contract with Eastern for a number of months and he felt as though it was at the point that he could get a commitment letter on that.* He didn't know, but he would see if he could.

* * *

Q. Did Kelly say anything else to you?

A. Yes, he said that Bob had been working with Tom for a number of months.

Q. Bob who?

A. Bob Bushnell [the NSMC account executive in charge of the Eastern account].

Q. And Tom who?

A. Tom Mullen and at that time, as I recollect, Eastern was our biggest client the previous year and for the coming year they had been working two or three months on a large program.

* * *

Q. Mr. Randell, at the time you had this conversation with Dennis Kelly or prior to that, did you know of any commitment from Eastern Airlines to spend $800,000 with National Student Marketing in 1970?

* * *

A. No, other than, as I know, other than the fact that *Mr. Mullen had agreed to the program,* but that is all. *That is all that I knew. That Mr. Mullen had agreed to go ahead with the program back in May.*

Q. Who told you this?

A. *Kelly had told me this a couple of months previously or Bob, one or the other, Bob Bushnell or Dennis Kelly.*

* * *

Q. What happened after you had this conversation with Kelly?

A. Kelly came back and said that he could get a commitment letter.

* * *

Q. What happened next?

A. He brought one into my offices and again just within the same day or the next day.

* * *

[Tr. 46-54, *United States v. Mullen* (S.D. N.Y. 74 Crim. 172)]

Randell's testimony in the subsequent prosecution supports the representations made to petitioner at the August 14 meeting—that NSMC executives had expended substantial resources on an Eastern proposal for several months and had obtained an oral commitment from Mullen in May—facts also supported by the workpapers delivered to petitioner the following day.[24] Randell's testimony demonstrates clearly that the prosecutor misstated the facts at petitioner's trial when he made the inflammatory argument to the jury that the Eastern commitment was a mythical construct that had first appeared "by magic [at] 3 o'clock in the morning" and that no responsible NSMC official had previously "peeped a word" concerning it.

Moreover, the circumstances strongly support an inference that the misstatements were deliberate. Randell pleaded guilty to conspiracy and fraud counts of the multi-count indictment in August 1974, and subsequently appeared before the grand jury in September and October 1974, before petitioner's trial began. Mullen was indicted in December 1974, less than a month after

[24] *See* pp. 17-19 *supra.*

petitioner's conviction. The assistant U.S. attorney who prosecuted petitioner was in charge of the entire investigation relating to NSMC, including the grand jury appearances of Randell, Kelly, and Mullen and the acceptance of guilty pleas from four NSMC officers, including Randell and Kelly. It is virtually certain, therefore, that he was aware, as Randell was later to testify as a government witness, that the Eastern commitment had in fact been given orally in May and that petitioner was testifying truthfully when he stated at the trial that Randell had told him, earlier in August, that written confirmation of an oral commitment from Eastern was expected. In any event, quite apart from the likely personal knowledge government counsel must have had as to the falsity of his opening and closing arguments the prosecution is chargeable with awareness of the evidence within its possession—evidence that directly contradicted by the version of key facts the government urged upon the jury. *See Giglio v. United States*, 405 U.S. 150, 154 (1972).

By failing to bring out all the facts surrounding the Eastern contract, the government was able to mislead the jury, and the court of appeals, into believing that if petitioner had sought confirmation of the Eastern contract by communication with Mullen, he would have discovered the falsity of that commitment. Randell's testimony at the Mullen trial, however, established that the commitment letter shown to petitioner was not binding only because of a secret side letter Randell gave Mullen simultaneously, making the "commitment" cancellable at will. The prosecution understandably chose

not to offer any proof of the secret side letter in support of the prosecutor's otherwise barren assertion that the Eastern contract was a "phony" and known to be bogus by petitioner. The revelation that Mullen and Randell had concealed the sham character of the transaction from NSMC's accountants would have devasted the government's contention at trial that petitioner had knowingly and willfully assisted NSMC's officers in distorting NSMC's financial condition. But by omitting any proof of the side letter, the government failed to show that the commitment letter Mullen signed was not binding. Accordingly, there was nothing in the government's case to show that the inclusion of Eastern in the unaudited statement of earnings rendered it "false," an essential element of the offense with which petitioner was charged. The government attempted to cover this gaping hole in its proof by asserting in counsel's argument a version that even its own witness now contradicts. Such conduct to procure a conviction certainly offends the dignity of the United States and petitioner's right to fair treatment. *Berger v. United States*, 295 U.S. 78, 88 (1935).

Exposure of all the facts concerning the Eastern contract shows that the key assumption made by the court below in affirming the conviction was untenable. The court of appeals concluded that petitioner's failure "to take the next step of seeking verification from Eastern" (App. 22a-23a) was chargeable as a knowing misstatement, the implicit assumption being that if petitioner had taken that step he would have discovered the "commitment" to have been a "phony." Yet the complete account of Mullen's duplicity shows the utter fallacy of this supposition: had petitioner made the additional inquiry the court below demanded, Mullen

would have provided the necessary confirmation—as indeed he did a short time later in connection with petitioner's *audit* of the 1969 figures.

It is settled law that the government deprives the defendant of a fair trial when it knowingly uses perjured testimony to convict, *see Mooney v. Holohan*, 294 U.S. 103 (1935), or selectively elicits testimony from a witness so that the jury is deliberately left with a "false impression." *Alcorta v. Texas*, 355 U.S. 28, 31 (1957). Indeed the prosecution's obligation to insure the fairness of the trial extends further, to the duty to correct a known misstatement of a witness, *Napue v. Illinois*, 360 U.S. 264 (1959), and to disclose evidence favorable to the accused, *Brady v. Maryland*, 373 U.S. 83 (1963). The government's conduct in this case, withholding from the jury the complete account of the Eastern contract and affirmatively misstating the actual facts in counsel's argument, is as antithetical to a fair proceeding as the actions this Court has previously condemned.

While the government's failure to prove the falsity of the Eastern contract was a point raised on petitioner's appeal to the court of appeals, the evidence of the government's misconduct was not fully revealed until Randell testified in the Mullen trial, while petitioner's petition for rehearing was pending in the court of appeals.[25] Accordingly, petitioner's contentions are properly cognizable by this Court and warrant summary action. *Ring v. United States*, ____ U.S. ____ (No. 73-6969, Nov. 11, 1974).

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[25]Petitioner promptly advised the court of appeals of the substance of Randell's testimony by letter dated October 28, 1975. The petition for rehearing was denied without comment on November 5.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 5, 1975

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1035 & 1036—September Term, 1974.

(Argued April 10, 1975 Decided July 28, 1975.)

Docket Nos. 75-1004, 75-1008

UNITED STATES OF AMERICA,

Appellee,

against

ANTHONY M. NATELLI and JOSEPH SCANSAROLI,

Defendants-Appellants.

Before:

HAYS, MULLIGAN and GURFEIN,

Circuit Judges.

Appeal from judgments of conviction entered after a jury verdict in the United States District Court for the Southern District of New York, Harold R. Tyler, *J.*, finding appellants, two accountants, guilty on a single count of violating 15 U.S.C. § 78ff(a) by making materially false statements in a proxy statement filed with the Securities Exchange Commission.

Held: As to Natelli, the evidence was sufficient to support the conviction and no errors of law were made. As to Scansaroli, the evidence with regard to one of the two specifications in the count was insufficient to show that he had failed to fulfill a duty arising from his position.

Affirmed in part; reversed and remanded in part.

JOHN S. MARTIN, JR., New York, N.Y. (Martin, Obermaier & Morvillo, Philip A. Lacovara and Betty J. Santangelo, New York, N.Y., and Hughes, Hubbard & Reed, Washington, D.C., of counsel), *for Defendant-Appellant Natelli.*

CHARLES A. STILLMAN, New York, N.Y. (Morrison, Paul, Stillman & Beiley, Peter H. Morrison, Benjamin Zelermyer and Edward D. Tanenhaus, New York, N.Y., of counsel), *for Defendant-Appellant Scansaroli.*

FRANKLIN B. VELIE, Assistant United States Attorney, New York, N.Y. (Paul J. Curran, United States Attorney, and Jed S. Rakoff, Audrey Strauss and John D. Gordan, III, Assistant United States Attorneys, of counsel), *for Appellee.*

VICTOR M. EARLE, III and CAHILL GORDON & REINDEL (Howard J. Krongard, William E. Hegarty, Mathias E. Mone, George Wailand, of counsel), for Peat, Marwick, Mitchell & Co. as *Amicus Curiae.*

CRAVATH, SWAINE & MOORE, New York, N.Y. (John R. Hupper, Robert Rosenman and J. Barclay Collins, New York, N.Y., of counsel), for American Institute of Certified Public Accountants as *Amicus Curiae.*

URFEIN, *Circuit Judge:*

Anthony M. Natelli and Joseph Scansaroli appeal from dgments of conviction entered in the United States Disict Court for the Southern District of New York on

December 27, 1974 after a four week trial before the Hon. Harold R. Tyler and a jury. Judge Tyler imposed a one year sentence and a $10,000 fine upon Natelli, suspending all but 60 days of imprisonment, and a one year sentence and a $2,500 fine upon Scansaroli, suspending all but 10 days of the imprisonment.

Both appellants are certified public accountants. Natelli was the partner in charge of the Washington, D.C. office of Peat, Marwick, Mitchell & Co. ("Peat"), a large independent firm of auditors, and the engagement partner with respect to Peat's audit engagement for National Student Marketing Corporation ("Marketing"). Scansaroli was an employee of Peat, assigned as audit supervisor on that engagement.

Appellants were charged and tried only on Count Two of a multi-count indictment against other defendants connected with Marketing.

Count Two of the indictment charged that, in violation of Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a),[1] four of Marketing's officers and the appellants, as independent auditors, "wilfully and knowingly made and caused to be made false and misleading statements with respect to material facts" in a proxy statement for Marketing dated September 27, 1969 and filed with the Securities Exchange Commission (SEC) in accordance with Section 14 of the 1934 Act, 15 U.S.C. § 78n.

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1 Section 32 provides in relevant part:

"Any *person . . . who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder* or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, *which statement was false or misleading with respect to any material fact*, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, . . ." (Emphasis added.)

The proxy statement was issued by Marketing in connection with a special meeting of its stockholders to consider *inter alia* a charter amendment increasing its authorized capital stock and the merger of six companies, including Interstate National Corporation ("Interstate") into Marketing.

Count Two of the indictment further charged that appellants, in attempting to reconcile net sales and earnings as originally reported in the annual report for the fiscal year ending August 31, 1968 with the amounts shown in the statement of earnings in the proxy statement, filed less than a year later, created an explanatory footnote that was materially false and misleading.[2] It was alleged that "as the defendants well knew but failed to disclose . . . (a) approximately one million dollars, or more than 20%, of the 1968 'net sales originally reported' had proven to be nonexistent by the time the proxy statement was filed and had been written off on [Marketing's] own internal books of account; (b) net sales and profits of 'pooled companies reflected retroactively' were substantially understated; and (c) net sales and profits of [Marketing] were substantially overstated."

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2 The footnote read in relevant part:

"Net sales and earnings as originally reported to stockholders in the annual report [for the year 1968] and the amounts as shown in the statement of earnings in this proxy statement are reconciled as follows:

Net sales	*1968*
Originally reported	$ 4,989,446
Pooled companies reflected retroactively	6,552,449
Per statement of earnings	$11,541,895
Net earnings	
Originally reported	$ 388,031
Pooled companies reflected retroactively	385,121
Per statement of earnings	$ 773,152"

Count Two charged further that the proxy statement also contained an unaudited statement of earnings for the nine months ended May 31, 1969 which was materially false and misleading in that it stated "net sales" as $11,313,569 and "net earnings" as $702,270, when, in fact, as the defendants well knew, "net sales" for the period were less than $10,500,000 and Marketing had no earnings at all.

In order to understand the theory of the government's case, we must retrace our steps to the beginning of the Peat engagement at Marketing. The jury could permissibly have found the following facts.

Marketing was formed in 1966 by Cortes W. Randell. It provided to major corporate accounts a diversified range of products to the youth market a diversified range of advertising, promotional and marketing services designed to reach the youth market. In April 1968 Marketing had its first and only public offering of stock. Peat was not its auditor at the time.

Peat took on the engagement in August 1968 after checking with the previous auditors that there had been no professional disagreement with management. Natelli, the partner in charge of Peat's Washington office, undertook the engagement to audit the financial statements of Marketing for the fiscal year ended August 31, 1968, and Natelli assigned Scansaroli to serve as supervisor on the engagement.

In late September or early October 1968 (after the close of the fiscal year), Randell and Bernard Kurek, Marketing's Comptroller, met with both appellants and discussed the method of accounting that Marketing had been using with respect to fixed-fee programs. In the fixed-fee program, Marketing would develop overall marketing programs for the client to reach the youth market by utilizing a combination of the mailings, posters and other advertis-

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ing services offered by Marketing. Randell explained that Marketing and the client agreed upon a fixed fee to be charged for participating in the various programs. Randell stated that the company believed that it was proper to recognize income on these fixed-fee contracts at the time the clients committed themselves to participate in the programs presented to them by the account executives, and that this was the accounting method that had been used in preparing the financial statements for the period ended May 31, 1968, which had been distributed to stockholders.

After considering alternative methods of accounting, Natelli concluded that he would use a percentage-of-completion approach to the recognition of income on these commitments, pursuant to which the company would accrue that percentage of the gross income and related costs on a client's "commitment" that was equal to the proportion of the time spent by the account executive on the project before August 31, 1968 to the total time it was estimated he would have to spend to complete the project.

The difficulty immediately encountered was that the "commitments" had not been booked during the fiscal year, and were not in writing. The Marketing stock which had initially been sold at $6 per share was selling in the market by September 1968 for $80, an increase of $74 in five months. A refusal to book the oral "commitments" would have resulted in Marketing's showing a large loss for the fiscal year—according to Kurek's computations, a loss of $232,000.

Scansaroli, upon Natelli's order, attempted to verify the "commitments," the sales not previously included in the company records, in a rather haphazard manner by telephone to representatives of companies which had purportedly indicated some intent to use Marketing's services. Pursuant to Randell's urging, Scansaroli did not seek any

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written verifications. He accepted a schedule prepared by Kurek which showed about $1.7 million in purported "commitments." He also received from the account executives forms indicating estimates of the gross amount of the client's commitment, the printing and distribution costs to be incurred on the program, and the account executive's estimate of the percentage of completion of the program.

On the basis of the above, Natelli decided not only to recognize income on a percentage-of-completion basis, but to permit adjustment to be made on the books after the close of the fiscal year in the amount of $1.7 million for such "unbilled accounts receivable." This adjustment turned the loss for the year into a handsome profit of $338,031, showing an apparent doubling of the profit of the prior year.

Appellants were not charged with a criminal violation with respect to this decision. It may be observed, however, that in the footnote to the audited financial statement for 1968 explaining this method of accounting for "Contracts in Progress," no indication is given of the flimsy nature of the evidence that such client "commitments" actually existed.

After the 1968 audit had been given a full certificate by the auditors on November 14, 1968, Natelli in December 1968 told the officers of Marketing that in the future Peat would allow income to be recorded only on written commitments, supported by contemporaneous logs kept by the account executives with respect to each contract. A form letter was drafted to spell out a binding contractual commitment to be signed by each client.

In the meantime, following the issuance of the 1968 audited annual report and before the September 1969 proxy statement, seven companies were acquired largely in exchange for Marketing stock, in reliance on the 1968 annual report.

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Things began to happen with respect to the $1.7 million of "sales" that had been recorded as income after fiscal year end. Within five months of publication of the annual report, by May 1969, Marketing had written off over $1 million of the $1.7 million in "sales" which the auditors had permitted to be booked.

Of the total $1 million written off, $748,762 was attributable to "sales" purportedly made by one Ronald Michaels, an account executive who was fired for taking kickbacks and who was said to be dishonest. The other quarter of a million dollars of sales written off had nothing to do with Michaels. When accrued costs were taken into account, the effect of the write-off of the Michaels contracts was to reduce 1968 income by $209,750. It appeared that of the $1 million of sales requiring retroactive write-off, $350,000 had already been written off by the company by subtracting these "sales" from 1969 *current* year figures. An additional $678,000 was to be written off sales for the prior year 1968, and appellants were asked to design the write-off. The write-off suggested by appellants was accepted and entered in the general ledger as a journal voucher entry sometime in late April or early May.

That entry wrote off the $678,000 retroactively as a deduction from 1968 sales. Instead of reducing 1968 earnings commensurately, however, no such reduction was made. Appellants were informed by tax accountants in Peat's employ that a certain deferred tax item should be reversed, resulting in a tax credit that happened to be approximately the same amount as the profit to be written off. Scansaroli "netted" this extraordinary item (the tax credit) with an unrelated ordinary item (the write-off of sales and profits). By this procedure he helped to conceal on the books the actual write-off of profits, further

using the device of rounding off the tax item to make it conform exactly to the write-off.[3] The effect of the netting procedure was to bury the retroactive adjustment which should have shown a material decrease in earnings for the fiscal year ended August 31, 1968.

The Proxy Statement

A. *The Footnote*

As part of the proxy statement, appellants set about to draft a footnote purporting to reconcile the Company's prior reported net sales and earnings from the 1968 report with restated amounts resulting from pooled companies reflected retroactively. The earnings summary in the proxy statement included companies acquired after fiscal 1968 and their pooled earnings. The footnote was the only place in the proxy statement which would have permitted an interested investor to see what Marketing's performance had been in its preceding fiscal year 1968, as retroactively adjusted, separate from the earnings and sales of the companies it had acquired in fiscal 1969.[4]

At Natelli's direction, Scansaroli subtracted the written-off Marketing sales from the 1968 sales figures for the seven later acquired pooled companies without showing

3 This procedure was approved by Natelli, for in the first printed draft of the proxy statement he prepared a footnote which lumped contract losses for 1968 and the tax adjustment, stating that "the net effect of the retroactive adjustment was a $21,000 decrease in net earnings for the year 1968."

4 A vigilant and knowledgeable stockholder who had saved his 1968 financial report could have discovered, by matching it with the balance sheet in the proxy statement, that unbilled receivables for the year ended August 31, 1968 were now $1,915,230 as against $1,763,992 in the earlier document, but he would not know why there was a difference. Footnote "c" read: "Figures for 1968 have been restated in certain instances to make their presentation consistent with current accounting practices. There was no material effect as a result of such restatement."

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any retroactive adjustment for Marketing's own fiscal 1968 figures. There was no disclosure in the footnote that over $1 million of previously reported 1968 sales of Marketing had been written off. All narrative disclosure in the footnote was stricken by Natelli. This was a violation of Accounting Principles Board Opinion Number 9, which requires disclosure of prior adjustments which affect the net income of prior periods.[5]

B. *The False Nine Months Earnings Statement*

The proxy statement also required an unaudited statement of nine months earnings through May 31, 1969. This was prepared by the Company, with the assistance of Peat on the same percentage of completion basis as in the 1968 audited statement. A commitment from Pontiac Division of General Motors amounting to $1,200,000 was produced two months after the end of the fiscal period. It was dated April 28, 1969.

The proxy statement was to be printed at the Pandick Press in New York on August 15, 1969. At about 3 A.M. on that day, Natelli informed Randell that the "sale" to the Pontiac Division for more than $1 million could not be treated as a valid commitment because the letter from

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5 Accounting Principles Board Opinion Number 9, issued December, 1966, reads in relevant part:

"26. When prior period adjustments are recorded, the resulting effects (both gross and net of applicable income tax) on the net income of prior periods should be disclosed in the annual report for the year in which the adjustments are made. [The Board recommends disclosure, in addition, in interim reports issued during that year subsequent to the date of recording the adjustments.] When financial statements for a single period only are presented, this disclosure should indicate the effects of such restatement on the balance of retained earnings at the beginning of the period and on the net income of the immediately preceding period."

APB Accounting Principles: Original Pronouncements, Vol. 2, p. 6562 (1969).

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Pontiac was not a legally binding obligation. Randell responded at once that he had a "commitment from Eastern Airlines" in a somewhat comparable amount attributable to the nine months fiscal period (which had ended more than two months earlier). Kelly, a salesman for Marketing, arrived at the printing plant several hours later with a commitment letter from Eastern Airlines, dated August 14, 1969, purporting to confirm an $820,000 commitment ostensibly entered into on May 14, just before the end of the nine-month fiscal period of September 1, 1968 through May 31, 1969. When the proxy statement was printed in final form, the Pontiac "sale" had been deleted, but the Eastern "commitment" had been inserted in its place.

Soon after the incident at Pandick Press, Douglas Oberlander, an accountant at Peat assigned by Natelli to review Marketing's accounts, discovered $177,547 worth of "bad" contracts from 1968 which were known to Scansaroli in May, as doubtful, but which had not been written off. Oberlander suggested to Kurek that these contracts and others amounting to over $320,000 in addition to the $1 million in bad contracts previously disposed of, be written off. Kurek consulted Scansaroli, who, after consulting with Natelli, decided against the suggested write-off.

The proxy statement was filed with the SEC on September 30, 1969. There was no disclosure that Marketing had written off $1 million of its 1968 sales (over 20%) and over $2 million of the $3.3 million in unbilled sales booked in 1968 and 1969. A true disclosure, which was not made, would have shown that without these unbilled receivables, Marketing had no profit in the first nine months of 1969.

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Each appellant contends that the evidence was insufficient to support his conviction. We shall consider each appellant separately.[6]

I

Natelli—Sufficiency of Evidence

It is hard to probe the intent of a defendant. Circumstantial evidence, particularly with proof of motive, where available, is often sufficient to convince a reasonable man of criminal intent beyond a reasonable doubt. When we deal with a defendant who is a professional accountant, it is even harder, at times, to distinguish between simple errors of judgment and errors made with sufficient criminal intent to support a conviction, especially when there is no financial gain to the accountant other than his legitimate fee.

Natelli argues that there is insufficient evidence to establish that he knowingly assisted in filing a proxy statement

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6 Natelli contends that a later incident reveals his lack of intent to deceive. In September 1969, John Johnston, a staff accountant with Peat, was assigned to prepare the audit of Marketing's books for the fiscal year ended August 31, 1969. He discovered the uncollectible contracts found by Oberlander in August and reported them to his superior, William Colona, who had replaced Scansaroli as audit supervisor when Scansaroli joined Marketing as an employee in October. Later in October, Peat was asked to prepare a "comfort letter" in connection with Marketing's acquisition of Interstate National Corporation, to assure Interstate that no adverse information concerning the unaudited statements for the period ended May 31, 1969 had been discovered since the acquisition contract had been signed in August. Colona and Johnston drafted a "comfort letter" noting adjustments which completely wiped out Marketing's first three-quarter earnings for 1969 of $700,000 as they had been carried in the proxy statement. Natelli acquiesced. The draft "comfort letter" did not deter Interstate from closing the transaction, and Peat decided, at the suggestion of Natelli, to send the letter to the other companies being acquired, which had failed to require such a "comfort letter" in their contracts. Natelli urged this at trial as proof of his good faith, and the trial judge fairly stated to the jury his contention in that regard.

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which was materially false. After searching consideration, we are constrained to find that there was sufficient evidence for his conviction.

The arguments Natelli makes in this court as evidence of his innocent intent were made to the jury and presented fairly. There is no contention that Judge Tyler improperly excluded any factual evidence offered. While there is substance to some of Natelli's factual contentions for jury consideration, we cannot find, on the totality of the evidence, that he was improperly convicted.

The original action of Natelli in permitting the booking of unbilled sales after the close of the fiscal period in an amount sufficient to convert a loss into a profit was contrary to sound accounting practice, particularly when the cost of sales based on time spent by account executives in the fiscal period was a mere guess. When the uncollectibility, and indeed, the non-existence of these large receivables was established in 1969, the revelation stood to cause Natelli severe criticism and possible liability. He had a motive, therefore, intentionally to conceal the write-offs that had to be made.

Whether or not the deferred tax item was properly converted to a tax credit, the jury had a right to infer that "netting" the extraordinary item against ordinary earnings on the books in a special journal entry was, in the circumstances, motivated by a desire to conceal.

With this background of motive, the jury could assess what Natelli did with regard to (1) the footnote and (2) the Eastern commitment and the Oberlander "bad" contracts.

A. *The Footnote*

Honesty should have impelled appellant to disclose in the footnote which annotated their own audited statement for

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fiscal 1968 that substantial write-offs had been taken, after year end, to reflect a loss for the year. A simple desire to right the wrong that had been perpetrated on the stockholders and others by the false audited financial statement should have dictated that course. The failure to make open disclosure could hardly have been inadvertent, or a jury at least could so find, for appellants were themselves involved in determining the write-offs and their accounting treatment. The concealment of the retroactive adjustments to Marketing's 1968 year revenues and earnings could properly have been found to have been intentional for the very purpose of hiding earlier errors.[7] There was evidence that Natelli himself changed the footnote to its final form .

That the proxy Statement did not contain a formal reaudit of fiscal 1968 is not determinative. The accountant has a duty to correct the earlier financial statement which he had audited himself and upon which he had issued his certificate, when he discovers "that the figures in the annual report were substantially false and misleading," and he has a chance to correct them. See *Fischer* v. *Kletz*, 266 F. Supp. 180, 183 (S.D.N.Y. 1967) (Tyler, *J.*). See also *Gold* v. *DCL Inc.*, 1973 CCH Fed. Sec. L. Rep. ¶ 94,036 at p. 94,168 (Frankel, *J.*). The accountant owes a duty to the public not to assert a privilege of silence until the next audited annual statement comes around in due time. Since companies were being acquired by Marketing for its shares in this period, Natelli had to know that the 1968 audited statement was being used continuously.

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7 Natelli contends that the write-offs were of sales of Michaels, an allegedly corrupt salesman, and that since Michaels had been fired, the problem was not likely to recur. But the Government proved that at a meeting on June 9, 1969 at which Natelli was present, the Controller produced charts showing that of the $1.5 million of 1968 sales analyzed, about $900,000 had been written off. Of these, about $700,000 were sales of Michaels, $200,000 of another salesman, Ganis. (In addition, a third salesman had accounted for $213,000 of the 1968 sales, not a dollar of which had yet been billed).

The argument that the disclosure was not material is weak, since applying write-offs only against pooled earnings, without further explanation, conceals the effect of the write-offs on the prior reported earnings of the principal company. It is the disclosure of the true operating results of Marketing for 1968, now come to light, that was material. Materiality is an objective matter, not necessarily limited by the accountant's own uncontroiled subjective estimate of materiality, see *United States* v. *Simon*, 425 F.2d 796, 806 (2 Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970). In any event, the Court charged that the earnings figures would have to be "known to be false in a material way"—a subjective test.

B. *The Eastern Commitment and the Nine-Month Earnings Statement*

The Eastern contract was a matter for deep suspicion because it was substituted so rapidly for the Pontiac contract to which Natelli had objected, and which had, itself, been produced after the end of the fiscal period, though dated earlier. It was still another unbilled commitment produced by Marketing long after the close of the fiscal period. Its spectacular appearance, as Natelli himself noted at the time, made its replacement of the Pontiac contract "weird."[8] The Eastern "commitment" was not only in substitution for the challenged Pontiac "commitment" but strangely close enough in amount to leave the projected earnings figures for the proxy statement relatively intact. Marketing had only time logs of a salesman relating to the making of the proposals but no record

8 Natelli's explanation that only the suggestion of Randell for *complete* replacement of the Pontiac contract *without changing the figures at all*, was "weird" is not convincing. Certainly the jury could find otherwise.

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of expenditures on the Eastern "commitment," no record of having ever billed Eastern for services on this "sale," and not one scrap of paper from Eastern other than the suddenly-produced letter. Nevertheless, it was booked as if more than $500,000 of it had already been earned.

Natelli contends that he had no duty to verify the Eastern "commitment" because the earnings statement within which it was included was "unaudited."

This raises the issue of the duty of the CPA in relation to an unaudited financial statement contained within a proxy statement where the figures are reviewed and to some extent supplied by the auditors. It is common ground that the auditors were "associated" with the statement and were required to object to anything they actually "knew" to be materially false. In the ordinary case involving an unaudited statement, the auditor would not be chargeable simply because he failed to discover the invalidity of booked accounts receivable, inasmuch as he had not undertaken an audit with verification. In this case, however, Natelli "knew" the history of post-period bookings and the dismal consequences later discovered. Was he under a duty in these circumstances to object or to go beyond the usual scope of an accountant's review and insist upon some independent verification? The American Institute of Certified Public Accountants, Statement of Auditing Standards No. 1—Codification of Auditing Standards and Procedures (1972), 1 CCH AICPA Professional Standards ¶516.09, recognizes that "if the certified public accountant concludes in the basis of facts known to him that unaudited financial statements with which he may become associated are not in conformity with generally accepted accounting principles, *which in-*

clude adequate disclosure, he should insist . . . upon appropriate revision . . . " (emphasis added).

We do not think this means, in terms of professional standards, that the accountant may shut his eyes in reckless disregard of his knowledge that highly suspicious figures, known to him to be suspicious, were being included in the unaudited earnings figures with which he was "associated" in the proxy statement.

The auditor's duty is not as restricted as appellants urge where, as here, the auditors, rather than the company, controlled the figures, as is evidenced by Natelli's rejection of the Pontiac contract as one he would not accept for the subsequent audited financial statement for 1969, and where the erroneous figures had previously been certified by his firm. Cf. *Fischer* v. *Kletz*, *supra*, 266 F. Supp. at 188, 189 (S.D.N.Y. 1967). We reject the argument of insufficiency as to Natelli, who could have pointed out the error of his previous certification and deliberately failed to do so, our function being limited to determining whether the evidence was sufficient for submission to the jury. *United States* v. *Simon*, *supra*, 425 F.2d at 799. We hold that it was. We discuss the objections to the charge below.

There are points in favor of Natelli, to be sure, but these were presented to the jury and rejected. These included, with their counterbalance: his rejection of the Pontiac commitment (with substitution of the Eastern contract); his discussion of the footnote with his superior, Leon Otkiss (without full disclosure to Otkiss of all relevant factors); his insistence on dissemination of the comfort letter (See note 6) (but his failure to disclose the huge past write-offs of Marketing resulting in no profit for 1968 or nine months of 1969).

Scansaroli—Sufficiency of Evidence

The claim of Scansaroli with respect to insufficiency of the evidence is somewhat more difficult. As Judge Tyler noted after both sides had rested, "It is a close question, I think frankly as to Scansaroli, as I see it. Certainly if I were the factfinder, I would be more troubled with his case for a variety of reasons."

Scansaroli contends that there was insufficient evidence to prove beyond a reasonable doubt that (1) he participated in a criminal act with respect to the footnote or (2) that he made an accounting judgment permitting Marketing to include in sales certain contracts-in-progress with the requisite criminal intent. We hold that there was enough evidence to establish the former, but not the latter. For reasons relating to the form of the charge, we will reverse and remand for a new trial.

A. *The Footnote*

The essence of Scansaroli's argument on his conviction with respect to the false footnote is that he was really convicted for his conduct during the 1968 audit, for which he was not indicted. This misses the thrust of the Government's claim. The unjustifiable manner of treating the unbilled commitments in the 1968 audit bore upon the illegal acts connected with the 1969 proxy statement in two ways: (a) it created a motive to conceal the accounting errors made in the 1968 audit; and (b) the 1968 audited statement was part of the 1969 proxy statement and was not disclosed therein to have been wrong in the light of the subsequent known write-offs. In view of the established motive to conceal, the jury could properly find, as we have seen, that both the netting of the tax credit against

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earnings and the subsequent subtracting of the write-offs from the pooled earnings in the footnote without further explanation were done in order to conceal the true retroactive decrease in the Marketing earnings for fiscal 1968.

There is some merit to Scansaroli's point that he was simply carrying out the judgments of his superior Natelli. The defense of obedience to higher authority has always been troublesome. There is no sure yardstick to measure criminal responsibility except by measurement of the degree of awareness on the part of a defendant that he is participating in a criminal act, in the absence of physical coercion such as a soldier might face. Here the motivation to conceal undermines Scansaroli's argument that he was merely implementing Natelli's instructions, at least with respect to concealment of matters that were within his own ken.

We think the jury could properly have found him guilty on the specification relating to the footnote. Scansaroli himself wrote the journal entry in Marketing's books which improperly netted the tax credit with earnings, the true effect never being pointed out in the financial statement. This, with the background of Scansaroli's implication in preparation of the 1968 statement, could be found to have been motivated by intent to conceal the 1968 overstatement of earnings.

Scansaroli participated in the decision to subtract in the proxy statement footnote $678,000 of written-off Marketing sales from the figures for later-acquired pooled companies instead of from its own figures, without further disclosure. Even if Scansaroli did not write the footnote, he supplied the misleading computations and subtractions though he was conscious of the true facts.

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B. *The Eastern Commitment*

Having concluded that there was sufficient evidence to convict both appellants on the footnote specification, we turn to the nine-months earnings statement which, in turn, included two items, the Eastern contract and the doubtful commitments discovered by Oberlander. We put aside the decision to ignore Oberlander's questioning of certain commitments on the ground that, if it stood alone, the evidence would have been too equivocal to support proof beyond a reasonable doubt that this was not a mere error of judgment.

With respect to the major item, the Eastern commitment, we think Scansaroli stands in a position different from that of Natelli. Natelli was his superior. He was the man to make the judgment whether or not to object to the last-minute inclusion of a new "commitment" in the nine-month statement. There is insufficient evidence that Scansaroli engaged in any conversations about the Eastern commitment at the Pandick Press or that he was a participant with Natelli in any check on its authenticity. Since in the hierarchy of the accounting firm it was not his responsibility to decide whether to book the Eastern contract, his mere adjustment of the figures to reflect it under orders was not a matter for his discretion. As we have seen, Natelli bore a duty in the circumstances to be suspicious of the Eastern commitment and to pursue the matter further. Scansaroli may also have been suspicious, but rejection of the Eastern contract was not within his sphere of responsibility. Absent such duty, he cannot be held to have acted in reckless disregard of the facts.

III

Appellants contend that the trial court erroneously instructed the jury on the issue of knowledge. We do not agree.

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The thrust of appellant's argument, as we understand it, is that the judge charged that each appellant could be convicted "if [his] failure to discover the falsity of [Marketing's] financial statements was the result of some form of gross negligence." We do not read the charge that way. It followed the charge of Judge Mansfield which was sustained in *United States* v. *Simon*, *supra*.[9]

It was a balanced charge which made it clear that negligence or mistake would be insufficient to constitute guilty knowledge. *See United States* v. *Bright*, —— F.2d ——, Slip Op. 3625 (2 Cir., May 21, 1975). Judge Tyler also carefully instructed the jury that "good faith, an honest belief in the truth of the data set forth in the footnote and entries in the proxy statement would constitute a complete defense here." On the other hand, "Congress equally could not have intended that men holding themselves out as members of these ancient professions [law and accounting] should be able to escape criminal liability on a plea of ignorance when they have shut their eyes

9 Judge Tyler charged, in pertinent part, as follows:

"While I have stated that negligence or mistake do not constitute guilty knowledge or intent, nevertheless, ladies and gentlemen, you are entitled to consider in determining whether a defendant acted with such intent if he deliberately closed his eyes to the obvious or to the facts that certainly would be observed or ascertained in the course of his accounting work or whether he recklessly stated as facts matters of which he knew he was ignorant.

If you find such reckless deliberate indifference to or disregard for truth or falsity on the part of a given defendant, the law entitled you to infer therefrom that that defendant wilfully and knowingly filed or caused to be filed false financial information of a material nature with the SEC.

But such an inference, of course, must depend upon the weight and credibility extended to the evidence of reckless and indifferent conduct, if any.

I repeat: Ordinary or simple negligence or mistake alone would be insufficient to support a finding of guilty knowledge, or wilfulness or intent."

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to what was plainly to be seen or have represented a knowledge they knew they did not possess." *United States* v. *Benjamin*, 328 F.2d 854, 863 (2 Cir.) *cert. denied, sub nom. Howard* v. *United States*, 377 U.S. 953 (1964); and *see United States* v. *Brawer*, 482 F.2d 117, 128-29 (2 Cir. 1973).

One of the bases for attack on the charge is that in charging "reckless disregard for the truth or falsity" or "closing his eyes," there must also be an instruction like "and with a conscious purpose to avoid learning the truth."

It is true that we have favored this charge in false statement cases, *United States* v. *Sarrantos*, 455 F.2d 877, 880-82 (2 Cir. 1972), while noting that both phrases "mean essentially the same thing," *id.* at 882; and in cases involving knowledge that goods were stolen, *United States* v. *Brawer*, *supra*, 482 F.2d at 128-29 (2 Cir. 1973); *United States* v. *Jacobs*, 475 F.2d 270, 287 (2 Cir.), *cert. denied*, 414 U.S. 821 (1973). The dual instruction is not necessarily required, however, when the defendant is under a specific duty to discover the true facts, the facts tendered are suspect, and he does nothing to correct them. In *United States* v. *Benjamin*, *supra*, 328 F.2d at 862, this court said, regarding an accountant, that "the Government can meet its burden by proving that a defendant deliberately closed his eyes to facts he had a duty to see." And *United States* v. *Simon*, *supra*, which affirmed the conviction of an accountant, as we have seen, sustained a charge in the very language Judge Tyler tracked.

While the facts in each case are not precisely the same, we think this appeal quite analogous to *Simon*, *supra*, because Natelli was suspicious enough of the Eastern contract to check it with Kelly, the account executive in house, but not to take the next step of seeking verification from

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Eastern, despite his obvious doubt that it could be booked as a true commitment. And with respect to the footnote, we think the language of this court in *Simon* to be quite pertinent, "The jury could reasonably have wondered how accountants who were really seeking to tell the truth could have constructed a footnote so well designed to conceal the shocking facts." 425 F.2d at 807.

Appellants argue strenuously, however, that *U. S.* v. *Simon, supra*, involved an audited statement while the nine months statement here involved was an unaudited statement, and, that hence, the duties of appellants here were different from those enunciated in *Simon*. They urge as a corollary that the District Court failed to instruct the jury on the difference, and that his failure to do so was reversible error.

It is true that the point on appeal might have been eliminated if the judge had charged on the differences in the abstract. But in the circumstances he was not required to do so. As we have seen, *supra*, Point I, the duty of Natelli, given this set of facts, was not so different from the duty of an accountant upon an audit as to require sharply different treatment of that duty in the charge to the jury.

We agree with Judge Tyler when he charged the jury that they could find Natelli "knew" of the falsely material fact if he acted in "reckless disregard" or deliberately closed his eyes to the obvious. The issue on this appeal is not what an auditor is *generally* under a duty to do with respect to an unaudited statement, but what these defendants had a duty to do in these unusual and highly suspicious circumstances. Cf. *United States* v. *Simon, supra*, 425 F.2d at 806-07. Nor was a proper charge requested.

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The duly requested supplemental charge on Natelli's duty with respect to the unaudited earnings statement was properly denied. It read:

> "The defendants' *only* responsibility as to this statement [unaudited statement of earnings for the nine months ended May 31, 1969] was to be satisfied that, *as far as they knew,* the statement contained no misstatement of material facts." (emphasis added).

This requested charge was not correct, for even on an unaudited statement with which Natelli was "associated" and where there were suspicious circumstances, his duty went further, as we have seen. As the Court correctly charged, Natelli was culpable if he acted in "reckless disregard" of the facts or if he "deliberately closed his eyes."

We expound no rule, to be sure, that an accountant in reviewing an unaudited company statement is bound, without more, to seek verification and to apply auditing procedures. We lay no extra burden on the normal activities of accountants, nor do we assume the role of an Accounting Principles Board. We deal only with such deviations as fairly come within the common understanding of dishonest conduct which jurors bring into the box as applied to the particular conduct prohibited by the particular statute.

It was not for Judge Tyler in his instructions to deal with the abstract question of an accountant's responsibility for unaudited statements, for that was not the issue. So long as we find that the Judge explicated the proper test applicable to the facts of this case, the duty inherent in the circumstances, and we do, we must also find that he gave the appellants a fair charge.

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IV

The Charge on "Unanimity"

The trial judge charged as follows:

> "Now, I instruct you that if you find that the proxy statement was false in either one of these two respects that is sufficient to support a conviction."

As we have seen, there were two specifications of falsity in Count II, namely, the footnote and the earnings statement. The defense requested that the court advise the jury that in order to convict, they must be unanimous on which, if either, of the two specifications had been proven materially false beyond a reasonable doubt.[10] This request was refused, and the court did not charge accordingly.

Appellants now contend that the charge given left the jury free to convict if only six of them believed the proxy statement to be materially false in one respect but the other six believed the proxy statement to be materially false in the other respect. Appellants conclude that even if the evidence was sufficient to warrant the submission of each of the allegedly false statements to the jury, the conviction still cannot stand, since it cannot be determined whether the jury did in fact unanimously agree on a single specification of falsity. Appellants cite no authority directly in point. The government cites no direct authority in this circuit, but cites two cases in the Ninth Circuit, *United States* v. *Friedman*, 445 F.2d 1076, 1083-84, *cert. denied, sub nom. United States* v. *Jacobs*, 404 U.S. 958 (1971) and *Vitello* v. *United States*, *supra*, 425 F.2d at 422-23, as directly in point. However, these cases are distinguishable.

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10 This was not a request for a special verdict. *Cf. United States* v. *Spock*, 416 F.2d 165, 180-83 (1 Cir. 1969); and see *U.S.* v. *Adcock*, 447 F.2d 1137 (2 Cir. 1971).

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In *Friedman*, the indictment alleged a conspiracy to violate several substantive statutes. The jury found appellants guilty of the conspiracy and of acts charged in particular substantive counts, thus indicating which violations in the conspiracy count the jury had found unanimously.

Vitello turned largely on the failure of counsel to object at trial. The court noted, however, that it would have had to follow *Yates* v. *United States*, 354 U.S. 298, 311-12 (1957) if "there was insufficient evidence to be submitted to the jury on any one or more of the specifications of falsity". 425 F.2d at 419.

The charge given by Judge Tyler is a charge generally given in this circuit. It is assumed that a general instruction on the requirement of unanimity suffices to instruct the jury that they must be unanimous on whatever specifications they find to be the predicate of the guilty verdict. We do not say it would be wrong for a trial judge to give the charge requested, but it is not error to refuse it.[11] And we do not change that rule.

The court properly charged that the jury needed only to find a defendant guilty on either of the two specifications in order to convict. Inasmuch as the evidence was sufficient to support Natelli's conviction on either specifi-

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11 In reaching this result, we believe that we are following *United States* v. *Remington*, 191 F.2d 246, 250 (2 Cir. 1951) (L. Hand, A. Hand & Swan, *JJ.*). There the defendant was convicted of perjury in falsely testifying before the Grand Jury that he had never been a member of the Communist Party. He had requested a charge that "all jurors must be convinced that the accused was a member of the Party 'at a particular time and place,' and if some thought he was at one time only and some another, they could not convict him." Judge Swan agreed that "that request was right and should be given if there is a new trial" but he refused to label it reversible error to refuse the charge "since the substance of it was probably covered, though not so explicitly, by the charge that the jury must be unanimous."

cation, the charge given presents no problem to affirmance as to him.

A difficulty does arise, however, if it is found as a matter of law that there should have been a directed verdict for a defendant on one of the specifications for insufficiency of evidence. The verdict then becomes ambiguous, for the jury could have rejected the specification which the appellate court holds sufficiently proved, and have convicted only on the specification held to be insufficiently proved. In that event, there seems to be no alternative to remand for a new trial. That is the general principle. *Yates* v. *United States*, *supra*; *Stromberg* v. *California*, 283 U.S. 359, 367-68 (1931). *See United States* v. *Jacobs*, *supra*, 475 F.2d at 283 and cases cited therein.

It is true, of course, that sometimes, as in conspiracy to violate two different substantive statutes, the same evidence may support conviction of conspiracy to violate either or both. *See e.g.*, *Jacobs*, *supra*, 475 F.2d at 282-84.

When there is more than one specification as a predicate for guilt, each dependent on particular evidence which is unrelated to the other, it would be sound practice to instruct the jury that they must be unanimous on a particular specification to convict. Since that was not done here and since we have found that Scansaroli was not culpable on the earnings-statement specification, the essence of which was the inclusion of the Eastern commitment, we must reverse his conviction and remand for trial on the footnote specification alone. We realize that we are reversing a conviction involving only 10 days of jail time. Whether it is important enough for the United States to retry him in the circumstances is a matter for decision by the United States Attorney on which we cannot pass judgment.

V

Appellants contend that Count II of the indictment should be dismissed for lack of proper venue. Prior to trial, appellants had jointly moved to dismiss Count II on the ground that proper venue lay only where the proxy statement had been filed with the Securities and Exchange Commission, the District of Columbia. The trial court denied the motion. We must consider the issue with the recognition that venue in criminal cases may raise "deep issues of public policy". *See United States* v. *Johnson*, 323 U.S. 273, 276 (1944).

Section 27 of the Securities Exchange Act, 15 U.S.C. § 78aa, provides that criminal proceedings for violations of the Act are to be brought in a district where "any act or transaction constituting the violation occurred." Appellants contend that the only critical act here was the filing of the proxy statement containing the false statements in the District of Columbia where it was delivered to the Commission, which is also where appellants' and Marketing's principal offices were. The government contends that there is venue for a charge of violation of section 32 of the 1934 Act, 15 U.S.C. § 78ff,[12] in the Southern District of New York as well. The government asserts that it has proved that the false footnote and the false nine months earnings statement were prepared in Manhattan, and that this suffices.[13]

In denying the pre-trial motion, the District Court held that the gravamen of the violation under Section 32 was the making of the false statement, not the filing, the words of the statute "required to be filed" merely describing a category of documents rather than the essence of the of-

12 See note 1, *supra*.

13 Appellants do not seriously contend that there was no preparation in the Southern District as a matter of fact.

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fense. The government, in support, notes the general venue provision for continuing offenses.[14]

Appellants retort that Section 27 of the 1934 Act stands apart from the continuing offense statute, arguing that it comes within the exception used when Congress has specifically provided for alternate venue. Appellants find support in *Travis* v. *United States*, 364 U.S. 631 (1961) which held that the proper venue for an offense under 18 U.S.C. § 1001, the False Statements Act, was not the district in which the false statement was made, but only the district where the affidavit had to be filed, the District of Columbia. The rationale of the decision, as we read it, was that section 1001 proscribes false statements "in any matters within the jurisdiction of any department or agency of the United States" and that the National Labor Relations Board had no such "jurisdiction" under Section 9(h) of the National Labor Relations Act as amended,[15] until the non-Communist affidavit required by the statute as a precondition to N.L.R.B. investigation was actually filed in Washington, D.C.[16]

The majority opinion in *Travis* was careful to note that "[t]he decisions are discrete, each looking to the nature of the crime charged." 364 U.S. at 635. And this court has

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14 18 U.S.C. § 3237(a) reads:

> (a) Except as otherwise expressly provided by enactment of Congress, any offense against the United States begun in one district and completed in another, or committed in more than one district, may be inquired *of* and *prosecuted* in any district in which such offense was begun, continued, or completed.

15 61 Stat. 136, 146, amended, § 1(d), 63 Stat. 601, 602, repealed, § 201 (d) of the Labor-Management Reporting and Disclosure Act of 1959, 73 Stat. 519, 525.

16 If the "jurisdiction of the agency" exists where the false statement is made, however, the continuing offense statute is applicable to venue even in section 1001 cases. *United States* v. *Candella*, 487 F.2d 1223 (2 Cir. 1973), *cert. denied*, 415 U.S. 977 (1974).

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annotated *Travis* by stating that "the decision surely was meant to be confined to the facts based on the unusual statute involved." *See United States* v. *Slutsky*, 487 F.2d 832, 839 n.8 (2 Cir. 1973), *cert. denied*, 416 U.S. 937 (1974). *See* also *United States* v. *Ruehrup*, 333 F.2d 641, 643 (7 Cir.), *cert. denied*, 379 U.S. 903 (1964); *Imperial Meat Co.* v. *United States*, 316 F.2d 435, 440 (10 Cir.), *cert. denied*, 375 U.S. 820 (1963).

Appellant seeks to come within the *Travis* holding by arguing that just as in *Travis* where the filing of the non-Communist affidavit was simply a prerequisite to future conduct, resort to NLRB processes, so the filing of a proxy statement is merely the prerequisite to future conduct, the solicitation of proxies. The argument is unsound.

In *Travis*, the labor board had no jurisdiction to make an investigation of labor practices "unless there is on file with the Board" a non-Communist affidavit. Here the filing of the proxy statement is part of the continuous process of the solicitation of proxies. Proxy statements are filed only at such time as the persons filing require proxies for some corporate purpose.[17] The filing and solicitations are part of the same process. We hold that there was venue in the Southern District of New York.

We have considered the other arguments raised by appellants and find them without merit. Judgment affirmed as to appellant Natelli; as to appellant Scansaroli judgment reversed and remanded for a new trial.

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17 We may note, that paradoxically, in most cases arising under the 1934 Act, the defendants would presumably contend that they wished to be tried in their home districts rather than in the District of Columbia. Here the appellants happen to live and work in the District of Columbia and have been tried elsewhere, a rather unusual situation.

APPENDIX B

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-eighth day of July one thousand nine hundred and seventy-five.

Present:

HON. PAUL R. HAYS

HON. WILLIAM H. MULLIGAN

HON. MURRAY I. GURFEIN

Circuit Judges,

United States of America,

Plaintiff-Appellee,

v.

Cortes W. Randell, Robert C. Purbaugh, John G. Davies, Dennis M. Kelly, Bernard J. Kurck, Anthony M. Natelli, Joseph Scansaroli,

Defendants

Anthony M. Natelli, Joseph Scansaroli,

Defendants-Appellants.

75-1004

75-1008

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed as to appellant Anthony M. Natelli but the judgment as to appellant Joseph Scansaroli be and it hereby is reversed and that the action as to appellant Joseph Scansaroli be and it hereby is remanded to said District Court for further proceedings in accordance with the opinion of this court.

A. DANIEL FUSARO,
Clerk

By Vincent A Cuda
Chief Deputy Clerk

APPENDIX C

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1035 & 1036—September Term, 1974.

(Decided October 6, 1975.)

Docket Nos. 75-1004, 75-1008

UNITED STATES OF AMERICA,

Appellee,

v.

ANTHONY M. NATELLI and JOSEPH SCANSAROLI,

Defendants-Appellants.

Before:

HAYS, MULLIGAN and GURFEIN,

Circuit Judges.

ON PETITION FOR REHEARING BY UNITED STATES

GURFEIN, *Circuit Judge:*

The United States petitions for rehearing of that portion of our decision, filed July 28, 1975, slip op. 5165, which reversed the conviction of Scansaroli and remanded for a new trial as to him.

Natelli and Scansaroli were tried and convicted on a single count of wilfully making and causing to be made false and misleading material statements in a proxy state-

ment. The single count specified two false statements: the "footnote" and the "nine-months earnings statement." This court found sufficient evidence on each specification to sustain Natelli's conviction but held as to Scansaroli that there was insufficient evidence to go to the jury on the second specification. On that basis, we concluded that as to Scansaroli the jury might have convicted only on the specification held to be insufficiently proved. Slip op. at 5191. We accordingly remanded for a new trial.

The government calls our attention to cases in this circuit which have held that a general motion to dismiss a count with several specifications is insufficient to preserve on appeal the point that where one of the specifications is insufficiently proved the conviction on the entire count must be reversed. These cases hold that, to preserve the point on appeal, a specific motion must be made in the trial court to withdraw the particular specification from jury consideration. *United States* v. *Mascuch*, 111 F.2d 602, 603 (2 Cir.), *cert. denied*, 311 U.S. 650 (1940); *United States* v. *Goldstein*, 168 F.2d 666, 671 (2 Cir. 1948).

No separate motion was made by Scansaroli to withdraw the earnings statement specification from consideration by the jury. He did move to strike evidence concerning the Eastern Airlines affair and also asked for an instruction that the jury had to be unanimous on each specification, but he did not move to dismiss the specification for insufficiency. The failure to move may have ben dictated by tactical considerations on the theory of his able counsel that it is easier to attack a weak specification in the hope of a spillover to the stronger one. Be that as it may, we feel bound to follow the *Mascuch-Goldstein* rule, particularly in view of its eminent authorship.

Accordingly, we are constrained to grant the government's petition for rehearing, and, upon rehearing, we

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withdraw our former determination and affirm the conviction of Scansaroli as well as Natelli.

We might suggest that in view of the turn Scansaroli's case has taken and the short sentence he received from Judge Tyler, the District Judge who inherits the case ought carefully to consider a Rule 35 application to suspend the 10 days of jail time imposed.

APPENDIX D

United States Court of Appeals

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the fifth day of November , one thousand nine hundred and seventy-five.

Present: HON. PAUL R. HAYS

HON. WILLIAM H. MULLIGAN

HON. MURRAY I. GURFEIN

Circuit Judges.

United States of America,
Plaintiff-Appellee,
v.
Carmen M. Randell, Robert C. Bushnell, John S. Davies, Dennis M. Kelly, Bernard J. Kurek, Anthony M. Natelli, Joseph Scansaroli,
Defendants,
Anthony M. Natelli, Joseph Scansaroli,
Defendants-appellants.

75-1001
75-1000

A petition for a rehearing having been filed herein by counsel for the appellant, Natelli

Upon consideration thereof, it is

Ordered that said petition be and hereby is DENIED.

A. Daniel Fusaro
A. DANIEL FUSARO
Clerk

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APPENDIX E

1. Amendment VI of the United States Constitution provides in pertinent part:

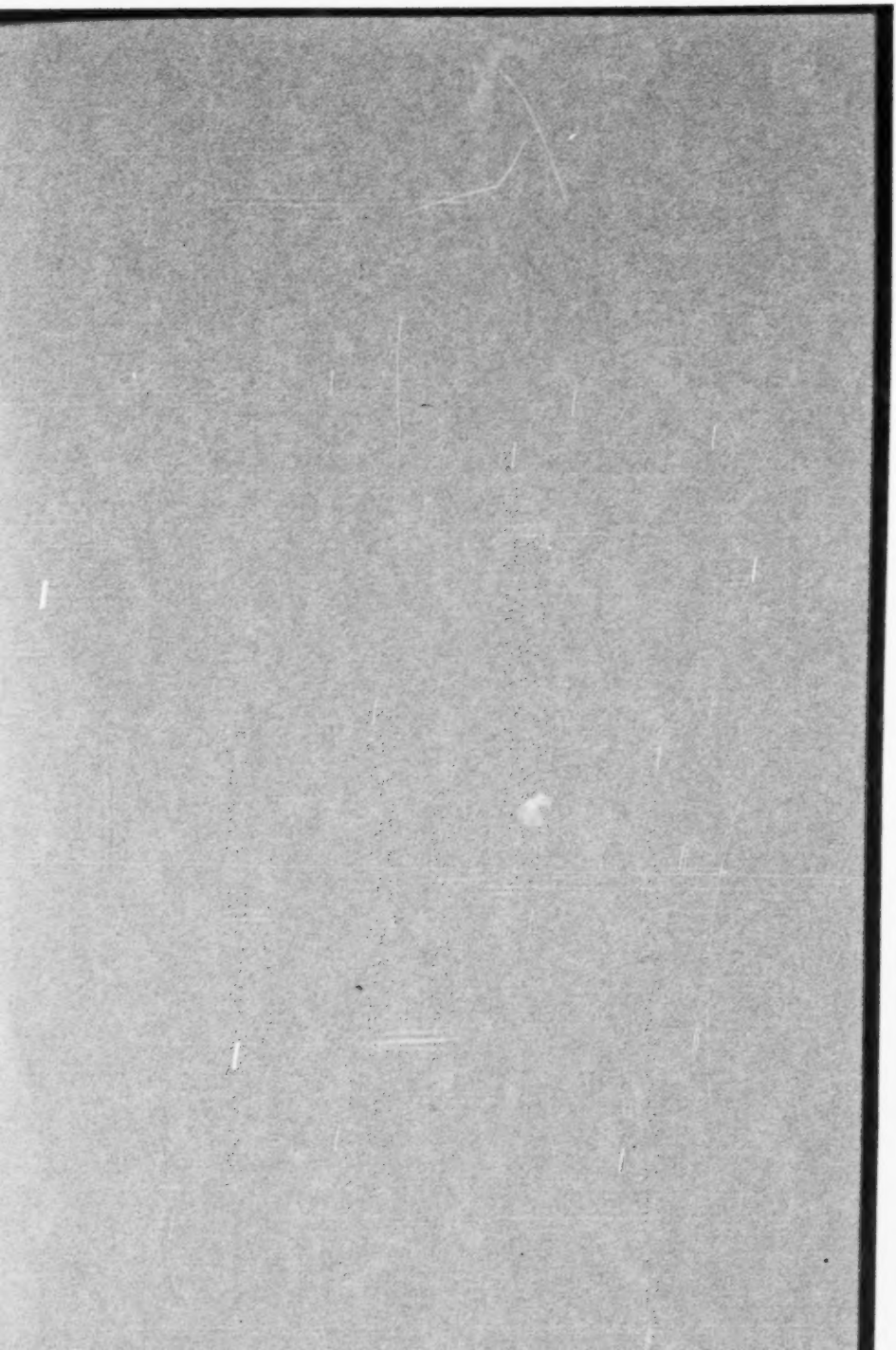
> In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law . . . .

2. Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. §78aa, provides in pertinent part:

> The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred.

3. Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78ff, provides in pertinent part:

> (a) Any person who . . . willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter . . . which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.



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No. 75-808

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

ANTHONY M. NATELLI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

SUPPLEMENTAL BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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v.

UNITED STATES OF AMERICA,

Respondent.

SUPPLEMENTAL BRIEF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

In the petition filed on December 5, 1975, petitioner advised the Court that the conviction of his co-defendant, Joseph Scansaroli, had initially been reversed and then reinstated on the government's petition for rehearing, and that Scansaroli's petition for rehearing of the reinstatement was pending before the court of appeals (Petition, p. 5 & n. 2; Pet. App. A & C.) This supplemental brief is submitted pursuant to Supreme Court Rule 24(5) to advise the Court that on December 4, 1975, the court of appeals granted Scansaroli's

petition, vacated its opinion and order on the government's rehearing petition, and again reversed Scansaroli's conviction.* A copy of the opinion of the court of appeals is attached as Appendix A to this supplemental brief. The opinion was filed on December 4 but did not come to the attention of petitioner's counsel until after the petition had been printed for filing with this Court on December 5.

Although the December 4 opinion of the Court below leaves undisturbed the affirmance of petitioner's conviction, several features of that opinion are relevant to the contentions raised in part III of petitioner's Reasons For Granting The Writ. (Petition, p. 33). There, petitioner asserts that because the indictment contained, in a single count, two distinct specifications of alleged falsity in the proxy statement, the

*The court of appeals had originally concluded that the evidence was insufficient to convict Scansaroli on the specification involving the Eastern contract and in its first opinion reversed his conviction, applying the rule that reversal is mandated "where the verdict is supportable on one ground, but not on another, and it is impossible to tell which ground the jury selected." *Yates v. United States*, 354 U.S. 298, 312 (1957). On the government's petition, the court then reinstated the conviction because of the alleged failure of Scansaroli's counsel to move in the trial court to withdraw the Eastern specification from the jury's consideration. The reinstatement was voided by the court's December 4 decision.

Petitioner, who also has urged that the government failed to prove the Eastern specification (Petition, p. 19, 43-44), did move for withdrawal of that specification, as the court below noted. (App. 5a, *infra.*)

Constitutional requirement of a unanimous jury verdict should have been implemented by jury instructions amplifying the usual admonition that the "verdict" must be unanimous. Had the specifications been contained in two difference counts, the jury would have been forced to come to grips with each specification and to convict only if unanimous on at least one discrete set of allegations. Because the trial court failed to instruct the jury that unanimity was required on at least one specification contained in the single count, however, petitioner was denied equivalent protection. In its opinion affirming petitioner's conviction, the court of appeals refused to insist on such an instruction, simply suggesting that because each specification was "dependent on particular evidence which is unrelated to the other," it would have been "sound practice" to have granted petitioner's request. (Pet. App. 27a.)

In its December 4 opinion, the court below again described the two specifications contained in the one count as presenting "two distinct incidents or fact patterns." (App. 3a, *infra.*) The court offered a suggestion that placing such specifications in separate counts "might well be the better practice in cases like this where the incidents charged as in violation of a statute are discrete." (App. 5a, *infra.*)

The court's characterization of the two specifications in the indictment as "distinct" and "discrete" supports petitioner's point that a juror's finding as to one specification in this case does not as a logical matter imply a similar finding as to the other, and that therefore agreement by all jurors on a particular evidentiary path to the verdict of guilty cannot reasonably be inferred. (Petition, p. 35.) The court of appeals acknowledged the hazards in any *post hoc*

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attempt to reconstruct the jurors' deliberations in these circumstances. Any need to engage in speculation about the jurors' agreement can, of course, be avoided where the government follows the court's suggestion of splitting the specifications into separate counts or where the trial judge gives proper instructions of the type requested here. Neither approach was taken in this case, however.

It is clear from the opinion below (App. 4a-5a, *infra*) that it is a common practice for the government to place specifications constituting "distinct incidents" in the same count of an indictment, as occurred here. Since the court of appeals did not purport to outlaw that practice, even for prosecutions within the Second Circuit, it is all the more important for this Court to grant certiorari here and to hold that, whenever such specifications are joined in a single count, the Constitutional requirement of unanimity on the essential facts and elements of the offense requires explicit instructions of the type refused to petitioner.

Respectfully submitted.

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December 1975

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1035 & 1036—September Term, 1975.

(Decided December 4, 1975.)

Docket Nos. 75-1004, 75-1008

UNITED STATES OF AMERICA,

Appellee,

v.

ANTHONY M. NATELLI and JOSEPH SCANSAROLI,

Defendants-Appellants.

Before:

HAYS, MULLIGAN and GURFEIN,

Circuit Judges.

On SCANSAROLI's Petition for Rehearing

GURFEIN, *Circuit Judge:*

This matter comes before the panel again on Scansaroli's petition for rehearing pursuant to our grant of permission. On the original appeal we had reversed appellant's conviction and remanded for a new trial.[1]

The single count charging violation of 15 U.S.C. § 78ff(a) upon which he was convicted involved the making of a

1 This opinion assumes knowledge of our original opinion, —— F.2d ——, Slip Op. 5165 (July 28, 1975).

false proxy statement which specified two false items therein: the "footnote" and the "nine-months earnings statement." We held that there was insufficient evidence to convict Scansaroli on the latter specification. See main opinion, Docket Nos. 75-1004, 75-1008, slip op. 5165, 5184, decided July 28, 1975.

We then granted a rehearing on the government's petition and held that under an old doctrine in this circuit we were constrained to decide that the failure of appellant specifically to ask the trial court to withdraw one of two specifications in a single count on the ground that it was insufficiently proved precluded appellate consideration. *United States* v. *Masouch*, 111 F.2d 602, 603 (2 Cir.), *cert. denied*, 311 U.S. 650 (1940); *United States* v. *Goldstein*, 168 F.2d 666, 671 (2 Cir. 1948).

We accordingly reversed ourselves on the decision to grant a new trial to Scansaroli. We now withdraw our opinion on rehearing and reconsider this difficult question of appealability *de novo*.

We start with the proposition that there are many criminal cases where the failure to object has resulted in affirmance under Rule 30 as applied in Rule 52(a). Appellant's rather strident cries that our decision against him is unprecedented is hardly impressive. Many convictions are denied appellate review for failure to call the alleged error to the attention of the trial court so as to enable it to consider correction before verdict. Otherwise appellate review would become a game of hindsight.

I

We recognize, nevertheless, that even under the *Masouch-Goldstein* line of cases, a proper request to the trial court would save the point. See, *e.g.*, *United States* v. *Adcock*, 447 F.2d 1337, 1338-39 (2 Cir.), *cert. denied*, 404 U.S. 939

(1971); *United States* v. *Pollak*, 474 F.2d 828 (2 Cir. 1973). And see also *Warszower* v. *United States*, 312 U.S. 342, 345 (1941).[3] As we indicated in our original opinion, that is because *Yates* v. *United States*, 354 U.S. 298, 311-12 (1957),[4] and *Stromberg* v. *California*, 283 U.S. 359, 367-68 (1931), can be read as covering the situation where a jury may have convicted on the very specification which is insufficiently proved to make out an offense.

That is true, especially, when the specifications in the single count relate to two distinct incidents or fact patterns, see *United States* v. *Guterma*, 281 F.2d 742, 747 (2 Cir.), *cert. denied*, 364 U.S. 871 (1960), rather than being merely a charge of alternate ways of violating a statute stated in the conjunctive. Cf. *United States* v. *Astolas*, 487 F.2d 275, 280 (2 Cir. 1973), *cert. denied*, 416 U.S. 955 (1974).

Assuming, as we have already in our original opinion, that reversal of the conviction of Scansaroli is required if counsel adequately raised the point below, we turn to the question of how much must be done by defense counsel to protect the record.

---

2 In *Adcock*, we reversed a conviction which charged the making of a false statement in violation of 18 U.S.C. § 1001 where the count ultimately reversed contained three assignments of falsity, two of which were sufficiently supported by the evidence. The government conceded on appeal that a proper motion to strike had been made pursuant to the *Mascuch Goldstein* rule, but argued that appellant should, in addition, have moved for a special verdict. We held in *Adcock* that a special verdict would have been improper and hence a motion for such a verdict was unnecessary.

3 There the defendant had moved to strike from the record or exclude from the consideration of the jury each of the four alleged false statements.

4 In *Yates* it is not clear what protective measures appellant had taken below. The Court of Appeals had noted that many motions had been made. 225 F.2d 146, 149 (9 Cir. 1955).

II

The Federal Rules of Criminal Procedure cast no light on the matter. Rule 29(a) simply provides for a motion for judgment of acquittal "of one or more offenses charged in the indictment or information after the evidence on either side is closed if the evidence is insufficient to sustain a conviction of such offense or offenses." No provision is made for a motion to withdraw one of two specifications in a single count on the ground of insufficiency. There may be an implication in Rule 30 that the failure to object to a particular specification is fatal because it amounts to a failure to object to an "omission" from the charge, but that is not clear. Finally, there is nothing in Rule 52(b) that tells us that the failure of the trial court to withdraw the particular specification *without request* is "plain error."

III

We must also consider the matter in practical terms, not only from the point of view of the particular defendant, but also in consideration of the requirements of the criminal justice process. Rule 7(c)(1) provides that "[i]t may be alleged in a single count that . . . he [the defendant] committed it [the offense] by one or more specified means." The government treats the separate incidents of "the footnote" and the "nine-months statement" as specified means for committing the single crime. See original opinion, slip op. at 5167-69. And no one doubts that for pleading purposes the prosecution is right.

The government has argued from this that if our original ruling stands, it would compel the government in any false statement case, simply out of caution, to allege each incident constituting the "means" of committing the offense in a *separate count* or risk the reversal of a convic-

tion based on afterthoughts on appellate review. We believe that this might be the better practice in cases like this where the incident charged as in violation of a statute are discrete. On the other hand, when that is not done, appellate review is not generally available when the particular insufficiency has not in some way been called to the attention of the trial judge. We do not believe that *Yates*, *supra*, in spite of its broad language, dictates a contrary result. Cf. *Turner* v. *United States*, 396 U.S. 398, 420 & n. 42 (1970).

What prompts our present consideration of Scansaroli's petition for rehearing is his argument that he did make it sufficiently clear to the trial judge that he wanted a judgment of acquittal or some equivalent on the "nine-months earnings statement" specification. On reconsideration, we agree that the arguments of counsel for Scansaroli with respect to the sufficiency of the evidence, his motion to strike the evidence relating to the Eastern commitment (an essential part of the "nine-months earnings statement" specification) and the *co-defendant's* specific motion to withdraw the specification on the nine-months earnings statement make this a close question.[5] Cf. *United States* v. *Lefkowitz*, 284 F.2d 310, 313 n.1 (2 Cir. 1960). As the Supreme Court has recently intimated in *Anderson* v. *United States*, 417 U.S. 211, 223 n.12 (1974), we may, in our discretion, consider a "sufficiency-of-the-evidence claim" even though the question arose below "only with respect to the admissibility of [certain] testimony." While *Anderson* also involved the question of whether the particular statute was *unconstitutionally* vague, and all the cases cited by Mr. Justice Marshall

5 We recognize that we cannot find fault with the distinguished District Judge, Harold Tyler, for not recognizing the various motions as a single request. We treat them, however, as sufficient to permit review in the interests of justice.

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involved similar *constitutional* questions, we have concluded that we have sufficient discretion to adopt the reasoning in *Anderson* on this appeal.

Accordingly, we do not purport to lay down a firm rule to govern the precise action required below for appealability where a single count contains more than one specification. Indeed, we could hardly do so without the empanneling of an *en banc* court. We decide simply, on further consideration, that appellant in this case did enough below to satisfy the spirit of the *Mascuch-Goldstein* rule. We accordingly withdraw our opinion on the government's petition and reinstate our original opinion as to Scansaroli in all respects. Cf. *United States* v. *Love*, 472 F.2d 490, 496 (5 Cir. 1973).

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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-808

ANTHONY M. NATELLI,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE*

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IN THE

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ANTHONY M. NATELLI,

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UNITED STATES OF AMERICA,

Respondent.

BRIEF OF AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS AS *AMICUS CURIAE*

Upon the consent of Petitioner and Respondent, the American Institute of Certified Public Accountants (the "Institute") submits this brief as *amicus curiae,* addressed to certain issues specified below, and urges this Court to grant the petition of Mr. Anthony M. Natelli for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

Opinions Below

The opinions of the United States Court of Appeals are annexed to the Petition for a Writ of Certiorari as Appendices A, B and C and to Petitioner's Supplemental Brief as Appendix A.

Question Presented

The Institute, as *amicus curiae,* addresses this brief solely to the first question presented by Petitioner.[1] That issue may be restated as follows:

May an independent public accountant be criminally convicted for violation of Section 32(a) of the Securities Exchange Act of 1934 on an indictment containing a specification that he made or caused to be made false and misleading statements in an unaudited financial statement contained in a proxy statement where the accountant had no actual substantive knowledge of the falsity of the unaudited financial statement and where the district court refused to charge that the duty of an accountant with respect to unaudited financial statements differs from his duty with respect to financial statements he had been engaged to audit.

Interest of the Institute as *Amicus Curiae*

The Institute is the only national accounting association whose membership is limited to certified public accountants; it has approximately 110,000 members. Among its purposes is the promotion and maintenance of high professional standards of practice and, in the pursuit of that purpose, the Institute has come to be accepted as the authoritative source of auditing standards and procedures in its field. Most particularly, the Institute develops the professional auditing standards which, after widespread exposure to its members, government and regulatory agencies, business entities and other interested persons, and formal approval by vote of its Auditing Standards Executive Committee,

[1] The Institute has not formulated and does not express a position with respect to any of the other issues presented by Petitioner.

are deemed "generally accepted" and which form the backdrop of this litigation.[2]

The Institute consequently has an obvious interest in the scope of criminal liability that is sought to be imposed on independent public accountants with respect to unaudited financial statements. That interest in this case transcends the usual interest of a professional association. Here the district court expressly refused to charge the jury with respect to the differences in an accountant's duty pertaining to audited and unaudited financial statements, despite the clear and compelling distinctions in professional responsibility as reflected in the Institute's SAS No. 1 § 516. On appeal the Second Circuit attempted to interpret SAS No. 1 § 516, but failed to correct the doctrinal chasm breached by the district court and added a new standard of suspicion not found in accounting literature. Thus, the issue addressed here has significance going far beyond the interests of the parties litigant and its resolution impacts the standards adopted by the Institute and concerns every member of the Institute and the accounting profession as a whole, already deeply concerned with the continuing task of meeting the evergrowing demands of the business community and investigating public for meaningful financial information at manageable cost.

Statement

Petitioner was indicted for having "wilfully and knowingly made and caused to be made false and misleading statements with respect to material facts" contained in a proxy statement of National Student Marketing Corpora-

[2] *See, e.g.*, AICPA, Statement on Auditing Standards No. 1—Codification of Auditing Standards and Procedures (1972) (hereinafter "SAS No 1").

tion ("NSM") dated September 27, 1969. Two specifications were contained in the count relevant to Natelli: (1) *specification relating to audited statements* — insufficient disclosure in a footnote to the audited financial statement contained in the proxy statement reconciling NSM net sales and earnings for the year ended December 31, 1968 as originally reported upon by Peat, Marwick, Mitchell & Co., with restated amounts shown in the statement of earnings contained in the proxy statement; and (2) *specification relating to unaudited statement*—the proxy statement contained a false unaudited statement of NSM earnings for the nine months ended May 31, 1969. Natelli was a partner of Peat, Marwick, Mitchell & Co., in charge of its Washington, D. C. office and the Peat, Marwick partner in charge of the NSM engagement.

The Petition contains a statement of the facts adduced at trial pertaining to each specification. It is sufficient to note here the principal fact relevant to the issue addressed by the Institute: it appears that Natelli did not have actual subjective knowledge that the unaudited NSM financial statement was false.

Both specifications of the single count of the indictment relevant to Natelli were presented by the district court to the jury on a theory that the jury should determine whether Natelli should have known that the footnote or the unaudited financial statement was false. The district court charged:

> "While I have stated that negligence or mistake do not constitute guilty knowledge of intent, nevertheless, ladies and gentlemen, you are entitled to consider in determining whether a defendant acted with such intent if he deliberately closed his eyes to the obvious *or to the facts that certainly would be observed or ascertained in the course of his accounting work* or whether he recklessly stated as facts matters of which he knew he was ignorant.

> If you find such reckless deliberate indifference to or disregard for truth or falsity on the part of a given defendant, the law entitles you to infer therefrom that that defendant wilfully and knowingly filed or caused to be filed false financial information of a material nature with the SEC.
>
> But such an inference, of course, must depend upon the weight and credibility extended to the evidence of reckless and indifferent conduct, if any.
>
> I repeat: Ordinary or simple negligence or mistake alone would be insufficient to support a finding of guilty knowledge or wilfullness or intent." App. I 2364-5 (Emphasis added)[3]

The court further charged, upon being requested by the jury during the course of its deliberations, that the instructions be repeated:

> "In this regard I went on to say parenthetically that outside auditors such as Peat, Marwick, Mitchell of course have no responsibility for the operations of management of a company such as NSMC.
>
> On the other hand, an auditor *must* ascertain when he is working on materials such as a proxy statement for a company that the financial statement in question, including such figures which are relevant or a footnote or footnotes that might be relevant contained therein, fairly present the results of the operations and the financial position of that accounting firm's client. Also an auditor *must* honestly believe that the financial statement is neither false nor mis-

[3] References denominated "App." are to the Appendix before the Second Circuit.

> leading in respect to material fact as I have defined material fact." App. I 2397-98 (Emphasis added).[4]

As further discussed under Point I, there is a vast difference between the accountant's professional duty concerning statements he is to audit and concerning unaudited statements. With respect to audited statements his duty is that set forth in his report:

> "We have examined the balance sheet of X Company as of (at) December 31, 19XX, and the related statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.
>
> "In our opinion, the financial statements referred to above present fairly the financial position of X Company as of (at) December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year." AICPA Statement on Auditing Standards No. 2 (1974)[5]

With respect to an unaudited statement, he has no independent duty to ascertain or report on its accuracy. A duty

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[4] A similar charge was given at App. I 2369.

[5] The Institute notes, in addition to the point made *infra*—namely, that the charge to the jury distorted an accountant's duty with respect to unaudited financial statements—that the charge erroneously states the role of an accountant with respect to *audited* statements. The financial position of a company, as noted in the text at note 14 *infra*, is not the finite certainty implied by the word "ascertain" employed by the district court. An accountant's role is judgmental as stated in the words of his opinion noted above.

only arises if he is aware that the unaudited financial statement is not in conformity with generally accepted accounting principles.[6]

Natelli, therefore, requested that the unaudited statement specification be dismissed and, failing that, requested the district court to charge the jury that

> "As to the unaudited statement of earnings for the nime months ended May 31, 1969, the defendants had no responsibility to render an opinion that the statement fairly presented the results of the client's operations. The defendants' only responsibility as to this statement was to be satisfied that, as far as they knew, the statement contained no misstatement of material facts." App. I 209.

That request was repeated on several occasions. *E.g.*, App. I 2384. The district court refused to give that charge or any other distinguishing an accountant's duty with respect to unaudited financial statements from his duty with respect to financial statements he has been engaged to audit. App. I 2384.

The jury returned a general verdict of guilty, thus making it impossible to know whether conviction was based on specification 1 or 2 or both. On appeal, the Second Circuit affirmed Natelli's conviction. The Opinion of the Court of Appeals is Appendix A to the Petition for Certiorari.

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[6] SAS No. 1 § 516.06. In instances involving an underwriter or an acquisition, an accountant is often asked to provide a "comfort letter" prepared on the basis of certain procedures he contractually agrees to perform. But even there he gives a negative assurance, stating for example that nothing has come to his attention which would indicate that the unaudited statement is not in conformance with generally accepted accounting principles. SAS No. 1 § 630.17.

ARGUMENT

POINT I

Certiorari should be granted to clarify the duty of an accountant with respect to unaudited financial statements with which he is associated.

This Court is now called upon to consider the standards applicable to the criminal liability of an independent public accountant under Section 32(a) of the Exchange Act with respect to *unaudited* financial statements. That issue is one never before considered by this or any other federal court.[7]

While the indictment was framed on the theory that Natelli knew of the falsity of the unaudited financial statement of NSM, the uncontradicted facts presented at trial, and the apparent assumption of both parties, demonstrate that he had no actual knowledge that the unaudited statement was false.[8] Thus, the issue here turns on the question of whether the jury was adequately instructed in considering if Natelli should have known of the falsity of that unaudited financial statement.

The jury's determination was made on the basis of charges which the Institute contends seriously distorted the role and duty of an accountant with respect to unaudited financial statements. Those charges violated the cogent and carefully drawn standards of the Institute, particularly SAS No. 1 § 516. That defect was not corrected by the Court of Appeals; the *dicta* that it was not

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[7] *United States* v. *Simon*, 425 F.2d 796 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970) and *United States* v. *Benjamin*, 328 F.2d 854 (2d Cir.), *cert. denied sub nom. Howard* v. *United States*, 377 U.S. 993 (1964), cited by the court below, involved audited financial statements.

[8] See the statement of the District Court at App. I 284.

changing the applicable standard[9] was internally inconsistent with its holding insofar as it did not reverse and vacate the judgment of the district court. Had the Court of Appeals fully applied the language of its own opinion to the district court's charge, it would have had no alternative but to reverse. Its failure to do so inserted a serious confusion in the law applicable to the conduct of accountants with respect to unaudited statements. That confusion in this important area of concern to all accountants and their clients, should be resolved by this Court, particularly since the district court's standard enjoys not a shred of support in accounting literature or law.

A. The Charge as a Whole Totally Distorted the Role of an Accountant With Respect to Unaudited Financial Statements

It is elementary that when an accountant undertakes to *audit* financial statements, he accepts the duty of performing an examination of the books and records of the client and of performing various auditing steps testing the entries on those books and records in order to express an opinion on the fairness with which the financial statements present the financial position, results of operations and changes in financial position in conformity with generally accepted accounting principles. *E.g.,* SAS No. 1 § 110.01. This involves development of an extensive audit program and requirements for testing and confirmation as reflected in the detailed professional standards articulated in the Institute's pronouncements. See SAS No. 1 §§ 320, 330.

But an accountant undertakes no such professional duty with respect to an unaudited financial statement with which he is associated.[10] An independent duty arises only

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[9] Pet. for Cert. App. A at 24(a).

[10] An accountant is associated with unaudited financial statements of a client if he permits his name to be used any place in a document containing them. SAS No. 1 §§ 516.03, 516.11, 516.12.

if he learns that the unaudited financial statement does not conform with generally accepted accounting principles. This sharp distinction in duty is set forth in SAS No. 1 § 516.06. It provides:

> "Because unaudited financial statements, by definition, have not been audited by the certified public accountant, he cannot be expected to have an opinion as to whether such statements have been prepared in conformity with generally accepted accounting principles. However, if the certified public accountant concludes on the basis of facts known to him that unaudited financial statements with which he may become associated are not in conformity with generally accepted accounting principles, which include adequate disclosure, he should insist (except under the conditions described in paragraph .05) upon appropriate revision; failing that, he should set forth clearly his reservations in his disclaimer of opinion. The disclaimer should refer specifically to the nature of his reservations and to the effect, if known to him, on the financial statements."

Thus, the accountant has no duty of verification with respect to unaudited financial statements. Although he may not consciously blind himself to the obvious, a duty of insistence upon revision or disclosure arises only if he concludes that generally accepted accounting principles were not observed.

This difference in kind was blatantly misconstrued by the district court. As noted, the jury was charged that it could find knowledge if it found that Natelli [a] "deliberately closed his eyes to the obvious or [b] to the facts that certainly would be observed or ascertained in the course of his accounting work or [c] whether he recklessly

stated as fact matters of which he knew he was ignorant." App. I 2364.

The district court failed to draw any distinction in duty between the footnote to the audited statements and the unaudited nine months statement and failed to distinguish a duty to investigate from a duty based on awareness. Instead, the district court presented the jury with a test of the three alternatives noted above, any one of which it charged would suffice to give knowledge. The second alternative, referring to "facts that certainly would be observed or ascertained in the course of his accounting work," expressly states and could have been interpreted by the jury only to mean that Natelli had a pre-existing obligation to perform "accounting work" with respect to the NSM unaudited financial statement. That implication and the nature of that "accounting work" the court made explicit. It charged that "an auditor must ascertain when he is working on materials such as a proxy statement . . . that the financial statement in question . . . fairly present[s] the results of the operations and the financial position of that accounting firm's client" and refused to charge that an accountant had a different duty with respect to unaudited financial statements, as noted above.

The district court's charge, therefore, enjoys no warrant in the professional standards applicable to accountants. Instead, it obliterated the obvious differences in professional duty with respect to unaudited and audited financial statements made plain in SAS No. 1 § 516 and thereby dramatically changed an accountant's duty with respect to unaudited financial statements.

B. The Jury Charges are Inconsistent With the Court of Appeals

Strangely, the charge of an independent duty with respect to unaudited financial statements is also inconsistent

with the very opinion of the Court of Appeals which sustained Natelli's conviction.

The Court of Appeals stated that:

> "In the ordinary case involving an unaudited statement, the auditor would not be chargeable simply because he failed to discover the invalidity of booked accounts receivable, inasmuch as he had not undertaken an audit with verification." *Pet. for Cert.* App. A at 16a.

It then relied on SAS No. 1 § 516.06 to find that a duty may arise when it is shown that the accountant knows that the unaudited financial statement was not in conformity with generally accepted accounting principles.[11]

Despite its recognition that an accountant has no independent duty with respect to unaudited financial statements, the court below failed to appreciate that the district court's charge incorporated a duty which the jury could have understood to be equivalent to an audit. As noted it combined its instructions for the footnote to the audited financial statement with those for the unaudited interim statement. In so doing, the district court necessarily assumed such an independent duty, namely, the performance of some "accounting work" with respect to unaudited financial statements and a duty to ascertain fair presentation.

The charge was, therefore, inconsistent with the opinion of the Court of Appeals analysis and the judgment should have been reversed. Under that analysis, Natelli was entitled to have a jury know that he had no independent duty

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[11] The Court of Appeals, however, interpreted SAS No. 1 § 516.06 to equate suspicion with knowledge. The impropriety of a suspicion standard is addressed in Point II *infra*.

to investigate or confirm the NSM unaudited financial statement, in deciding whether Natelli had the requisite knowledge to impose on him a duty of inquiry. Further, under that analysis, the jury had to determine if the true facts were in the scope of inquiry and whether the duty was criminally breached. The issue of whether Natelli had such a duty, however, was taken from the jury by the district court's charge.

C. The Petition Should Be Granted to Eliminate the Confusion Resulting From the Opinion of the Court of Appeals Affirming the Charge to the Jury and to Firmly Establish a Standard of Conduct in an Area Important to the Conduct of Financial Affairs in Light of the Securities Laws

The Petition for Certiorari should thus be granted, not only because a disturbing circumstance is raised since the charge to the jury is inconsistent with the professional standards applicable to Natelli and inconsistent with the opion which affirms it, but because the state of the law in this area has now been reduced to utter confusion.

Presumably, unless *certiorari* is granted, accountants in future cases could now be subject to criminal liability on the charges submitted to the jury below since those charges were sustained by the Court of Appeals. Yet, since those charges are inconsistent with the analysis of the Court of Appeals and with the professional standards, clarification is required. No accountant should have to be put to the uncertainty now extant and no court should have to elect between the charges sustained here and the language sustaining them. The Petition should be granted, if for no other reason, in order to lend certainty to this area.

Furthermore, since the issue here is of paramount concern to accountants and directly affects their performance

on nearly every financial statement filed with the SEC involving unaudited financial statements, the dramatic change in professional duty incorporated in the district court's charge should be considered by this Court before it becomes the standard applicable to such statements. That consideration is particularly required in this case since neither the Exchange Act nor its legislative history contains a single indication that Congress ever desired to enact the standard promulgated by the district court and approved by the Court of Appeals. Moreover, not even the SEC, even assuming it has power to make such a rule under Section 23 of the Exchange Act, has incorported the district court's improvident standard. The continued viability of that standard, therefore, demands this Court's attention and review.

POINT II

An accountant should not be criminally liable merely because he has knowledge of suspicious circumstances.

Instead of requiring actual knowledge of the falsity of an unaudited financial statement filed with the SEC, the court below held that an accountant could be convicted of criminal fraud on the basis that he knew that the unaudited financial statement contained suspicious figures. It interpreted the knowledge standard of SAS No. 1 § 516.06 to mean that the accountant "may [not] shut his eyes in reckless disregard of his knowledge that highly suspicious figures, known to him to be suspicious, were being included in the unaudited earnings figures with which he has was 'associated' in the proxy statement." *Pet. for Cert.* App. A at 17a.

This interpretation distorts SAS No. 1 § 516. There, a duty to disclose arises only if the accountant believes

that an unaudited financial statement does not conform to generally accepted accounting principles.

Moreover, suspicion, as a standard upon which criminal liability of accountants, or other professionals is to be based, is too imprecise and overbroad. The most obvious problem inherent in that term is the ability to manipulate it into a conviction for criminal violation of Section 32 of the Exchange Act by attaching its label to data lodged somewhere in the accountant's work papers and applying it to those facts "in the bright gleam of hindsight"[12] after discovery of the fraud of corporate management.

Furthermore, by imposing criminal liability on an accountant for failure to verify items which appear to be highly suspicious in effect imposes liability for negligence. As Chief Judge Cardozo noted in rejecting negligence as a standard of accountant's civil liability to third parties and as this Court recently repeated:[13]

> "The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences. *Ultramares Corp.* v. *Touche,* 255 N.Y. 170, 174 N.E. 441, 444 (1931).

It is the Institute's point that the hazards to be imposed upon accountants by the term "suspicious figures" are so extreme as to cast doubt on the creation of a duty on that basis with respect to unaudited financial statements.

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[12] *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833, 867 (2d Cir. 1968) (*en banc*) (Friendly, J. concurring), *cert. denied,* 349 U.S. 976 (1969).

[13] *Blue Chip Stamps* v. *Manor Drug Store,* 43 U.S. L.W. 4707, 4715 (U.S. June 9, 1975).

It is one thing to hold, as in *United States* v. *Simon, supra,* and *United States* v. *Benjamin, supra,* that an existing duty to audit was breached by an accountant who closed his eyes to facts he knew; it is quite another to base the creation of a duty on the basis of suspicion and to impose criminal liability for its breach. Where a duty exists, the accountant knows that he has to satisfy it. But where no such extensive independent duty exists, as in this case of an unaudited statement, the creation of a duty resting on the foundation of suspicion is far too vague and uncertain to serve as a basis for criminal liability.

Thus, the court below should have accepted SAS No. 1 § 516 as it stands The uncertainty of the term "suspicion" and the possible breadth of its scope will have the consequence not only of exposing accountants to criminal liability on a loosely defined concept, but of destroying the differences in duty pertaining to audited and unaudited financial statements. Even in an audit, as the Chief Accountant of the Commission recently observed, "The 'financial position' [of the client] is not an absolute which has been precisely defined or is readily apparent."[14] Accordingly, where an accountant sees an unaudited statement, numerous items might, at first blush, appear to be suspicious. Most life situations contain elements that could engender a healthy suspicion if viewed with a cold eye and uncharitable mien. The possible creation of a duty in such circumstances may therefore result in requiring every accountant to audit all financial statements contained in a document where his name appears.

If a change of that magnitude is to be desired, the Institute submits that it should come from Congress and not

[14] Burton, Fairness: Another View, Changing SEC Financial Disclosure and Rules—1975 (New York Law Journal, 1975).

from the courts below. It cannot fairly be said that investors reading a prospectus could have expected the accountants to have performed such tasks with respect to a statement he did not undertake to audit.[15]

The uncertainty of suspicion as a base for the creation of a duty and the consequences of such uncertainty, none of which were examined by the court below, therefore demand its rejection. *Certiorari* should be granted to address these issues and to eliminate or minimize the risks and consequences implicit in the suspicion standard adopted by the court below.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should be granted with respect to the first question presented by Petitioner.

Respectfully submitted,

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[15] Indeed, Regulation S-X, Rule 2-02. promulgated by the SEC, is apparently based on this assumption since it requires an accountant to render an opinion only on financial statements he audits.

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IN THE

Supreme Court of the United States

October Term, 1975

No. 75-808

ANTHONY M. NATELLI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF ON BEHALF OF PEAT, MARWICK, MITCHELL & CO., *AMICUS CURIAE*, IN SUPPORT OF THE PETITION FOR A WRIT OF *CERTIORARI*

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This brief is submitted (with the consents of the petitioner and respondent which have been filed with the Clerk) on behalf of Peat, Marwick, Mitchell & Co. ("Peat, Marwick") in further support of the petition for *certiorari*.

Interest of Peat, Marwick, Mitchell & Co.

Until his conviction petitioner was a member of Peat, Marwick, and Peat, Marwick has always supported and now supports his defense. Beyond this particular interest, Peat, Marwick believes that there is another reason for the grant of the writ and that there is another controlling question of federal law presented which has not been but should be settled by this Court. They are of immense im-

portance both to Peat, Marwick, one of the largest partnerships of accountants in the United States, and to the profession of which its partners and professional staff are members. The reason and question are not expressly submitted in the petition. *See* Supreme Court Rule 42.1, .3.*

Question Presented

The following controlling question is presented and should be considered by the Court:

> In a criminal prosecution under Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78ff (a), alleging the knowing and willful misstatement of a material fact, must the jury be instructed to consider the defendant's culpability in respect of the materiality of the alleged misstatement both against an objective standard and as a question of whether the defendant, albeit objectively mistaken, honestly believed the fact to be immaterial?

ARGUMENT

The instructions to the jury by the district court and the decision by the court of appeals stand for the proposition that in a criminal prosecution under the securities laws for a knowing misstatement of a material fact the jury need not consider whether the defendant professional honestly believed the fact to be immaterial. The court of appeals concluded:

> "Materiality is an objective matter, not necessarily limited by the accountant's own uncontrolled subjec-

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* Since the second question presented by the Petition relates to the issue of knowledge, the question stated herein may be comprised therein. *See* Supreme Court Rules 23.1(e) and 40.1(d)(1).

tive estimate of materiality, see *United States* v. *Simon*, 425 F.2d 796, 806 (2 Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970)." (App. 15a to the Petition).*

The decision below poses a profoundly frightening prospect for accountants—and for lawyers or for that matter any other professional or layman who has responsibility for the contents of documents filed with the Securities and Exchange Commission. Such documents, which describe the affairs of complex business enterprises, are necessarily the products of judgments, most particularly judgments of materiality or immateriality, which in a practical sense are judgments of significance or insignificance and of inclusion or omission.

Precisely such a judgment of insignificance and of consequent omission is in issue here. The first specification of the indictment was directed to the fact that a footnote to NSMC's restated 1968 financial statements in its 1969 proxy statement did not separately set forth either the subsequent write-off of certain sales, costs and earnings

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* The court of appeals also said:

"In any event, the Court charged that the earnings figures would have to be 'known to be false in a material way'—a subjective test." (App. 15a to the Petition).

The pertinent portions of the district court's instructions concerning objective materiality and knowledge are set forth in the appendix hereto. We do not believe that any juror could have perceived the significance found by the court of appeals in the phrase it quoted. All that the jurors could have understood is that materiality is an objective question and that the question of knowledge relates to accuracy—not to materiality. In any case, the court of appeals established a rule of law for the future which definitively eliminates the issue of the honesty of the defendant professional's subjective judgment concerning materiality.

We also submit, as we did below, that the district court's charge concerning objective materiality, a question which is before this Court in *Northway, Inc.* v. *TSC Industries, Inc.*, No. 74-1471 (Oct. Term 1975), was itself erroneous: the district court instructed that materiality was established if the misstatement would "matter to" or "concern" a reasonable person (Appendix hereto, p. A2).

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reflected in the 1968 financial statements previously issued or the counterbalancing reversal of an unnecessary 1968 tax reserve, which together produced the insignificant net income effect of $21,000.

The practice of accountancy leading to the expression of opinions concerning the financial statements of business enterprises is quintessentially the making of judgments. The auditor's opinion speaks only to the fairness of presentation of the financial statements as a whole in accordance with generally accepted accounting principles. As the most obvious example of the judgmental quality of such opinions, the almost universally followed accrual method of accounting demands estimation and cannot produce certainty or precision.

We believe it may be assumed that the judgments made by accountants in the practice of their profession, although sometimes mistaken and sometimes the basis for civil liability, are, in all but the rarest cases, honestly made. But the decision below says that, in a criminal prosecution, the subjective honesty of a professional judgment is not pertinent if a lay jury finds that judgment objectively erroneous. *Mens rea* becomes immaterial to the determination of guilt or innocence.

In the context of the civil standard of liability which is before this Court in *Ernst & Ernst* v. *Hochfelder*, No. 74-1042 (Oct. Term 1975), *argued* December 3, 1975, the Securities and Exchange Commission submitted that accountants should not be held liable for mistaken judgments if honestly and conscientiously made. The Commission said:

> "Accountants, like other professional experts, are required to make difficult judgments reflecting the current status of the learning of their profession. They

should not be held to have performed their work negligently because their judgment, although honestly and conscientiously made, turns out on hindsight to have been mistaken." Brief for the Commission, *amicus curiae,* at 20n.14.

The necessary intendment of a criminal provision which is addressed to a "willful and knowing" misstatement of "material fact" is that the issue of knowledge relates both to the alleged misstatement and to the materiality of the misstatement. Section 32(a) makes no distinction whatsoever between the elements of misstatement and of materiality. *See* Section 2.02(4) of the A.L.I., *Model Penal Code* (Proposed Official Draft 1962), which provides:

> "When the law defining an offense prescribes the kind of culpability that is sufficient for the commission of an offense, without distinguishing among the material elements thereof, such provision shall apply to all the material elements of the offense, unless a contrary purpose plainly appears."

Moreover, the Act under which the indictment here was drawn expressly requires that the question of the defendant's own judgment of materiality be clearly put to the jury. Section 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78 w(a), provides that:

> "No provision of this chapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission . . . ." *

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* This provision was amended in 1975 to extend also to SEC orders. *See* Section 23(a)(1), 15 U.S.C.A. §78w(a)(1) (1975).

Rule 3.02 of the Commission's Regulation S-X, 17 C.F.R. § 210.3-02 (1975), the regulation which deals with financial statement presentation, provides that:

> "If the amount which would otherwise be required to be shown with respect to any item is not material, it need not be separately set forth." *

Thus, no liability, civil or criminal, can attach under the Securities Exchange Act of 1934 to a failure to state separately in a financial statement an amount which in good faith is believed to be immaterial.

In the context of civil litigation under the federal securities laws, whether the defendant was cognizant of the materiality of the matter allegedly misstated or omitted has been recognized as an element in determining liability. In *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 369 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973), the Court of Appeals for the Second Circuit noted the "reasonable area of discretion in determining how far to explore the facts and in deciding what facts need be disclosed." In that connection the Second Circuit stated:

> "We do not hold that a corporation prima facie has acted unreasonably if the omission or misstatement is material. Corporate officials must be allowed considerable room for discretion; otherwise their normal functions as corporate officials will be inhibited. The to-

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* The controlling pronouncements of the accounting profession also advise accountants that ordinarily governing principles:

> "have application only to items material and significant in the relative circumstances. . . . [I]tems of little or no consequence may be dealt with as expediency may suggest."

APB, *Accounting Principles* § 510.09 (1968). *See also* AICPA, *Statements on Auditing Procedure No. 33* at 17 (1963); AICPA, *Statement on Auditing Standards No. 1* § 150.03-.04 at 6 (1973).

> tality of the facts and circumstances must be examined to determine whether the officials were reckless or grossly negligent." 480 F.2d at 369n.24.

The courts of appeals for other circuits have recognized this principle. In *SEC* v. *Coffey*, 493 F.2d 1304 (6th Cir. 1974), *cert. denied*, 420 U.S. 908 (1975), the Court of Appeals for the Sixth Circuit required the plaintiff to prove not only that the defendant knew or should have known of the allegedly omitted facts, but also, that the defendant

> "knew or should have known that the omitted information was significant . . . ." 493 F.2d at 1314.

Similarly, in *Vohs* v. *Dickson*, 495 F.2d 607 (5th Cir. 1974), the Court of Appeals for the Fifth Circuit, quoting from the Second Circuit's decision regarding the issue of scienter in *Cohen* v. *Franchard Corp.*, 478 F.2d 115, 123 (2d Cir.), *cert. denied*, 414 U.S. 857 (1973), held:

> "The standard for determining liability under Rule 10b-5 essentially is whether plaintiff has established that defendant . . . knew the material facts that were misstated or omitted *and* should have realized their significance . . . ." 495 F.2d at 622 (emphasis added).

The single citation by the court of appeals in support of its ruling was *United States* v. *Simon*, 425 F.2d 796, 806 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970). We submit that *Simon* does not support, but rather directly contradicts, the court's ruling.

The page in *Simon* cited by the court related only to whether expert testimony of objective non-materiality must be given conclusive effect—a question which *Simon* answered in the negative. But the issue here is different. It is one of ***mens rea***, of culpability, of criminal knowledge—

not the preliminary question of whether a statement or omission, when judged objectively, is or is not material.*

The aspect of *Simon* which is indeed pertinent and contradictory of the court of appeal's reliance upon it, is the charge given by the district court in *Simon*. There, the jury was instructed to consider "whether [the defendant accountants] acted in good faith and on the mistaken assumption that netting might be a possibility" (*Simon* Tr. p. 4028). No such instruction was given here, and the decision of the court of appeals is that no such instruction need ever be given.

It was just such an instruction as that given in *Simon* which the facts of this case required.** Concededly, the footnote to NSMC's restated 1968 financial statements in its 1969 proxy statement did not separately set forth either that certain sales, costs and earnings reflected in the 1968 financial statements which NSMC had issued in 1968 had been later written off or that an unnecessary 1968 tax reserve had been reversed. The petitioner relied upon the judgment that explicit footnote disclosure of these two facts was of little significance to an investor's perception of what in September 1969 was a company radically different by reason of acquisitions and other changes from what it had been in November 1968 when NSMC's 1968 financial statements had first been issued.

The failure of the district court to instruct the jury to consider whether petitioner had, as charged in *Simon*, "acted in good faith and on the mistaken assumption that

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* We do not argue that a defendant professional's assertion that he believed a matter to be immaterial or insignificant is determinative of the issue of *mens rea*. We submit rather that the jury must be instructed to assess the honesty of his belief in deciding whether the defendant acted "willfully and knowingly".

** The reference by the court of appeals here to "netting" (App. 13a to Petition) should be compared with the charge to the jury in *Simon*.

netting might be a possibility", removed from the case the factors which petitioner contended permitted him to reach the judgment he did:

(1) The sales and earnings figures in the summary of earnings itself were accurate, and the reversal of the deferred tax liability was shown there as an extraordinary credit.

(2) An authoritative pronouncement of the accounting profession treated a footnote of this nature as a matter relating primarily to earnings trends, not sales.

(3) The impact of the write-offs on net earnings—the "bottom line"—was only $21,000, an inconsequential amount.

(4) The NSMC account executive, whose wrongdoing had apparently caused the problem of the written-off amounts, was no longer with NSMC. Adequate explanation of the write-offs seemed to require, however, pointed and possibly defamatory description of his conduct.

(5) Income from fixed-fee sales was, at that time, being accrued only if evidenced by a firm written commitment in a form agreed upon between NSMC and Peat, Marwick (in contrast to the 1968 oral commitments), and NSMC's experience with written commitments had been good.

(6) As a result of a number of acquisitions, NSMC's business had been substantially changed and enlarged since August 31, 1968 and thus the fixed-fee programs had become a much less significant element of NSMC's business.

(7) Petitioner's judgment was concurred in by a more senior Peat, Marwick partner who was responsible for reviewing the NSMC proxy statement.

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As the opinion of the court of appeals suggests (App. 14a to Petition), petitioner's judgment might have been made so as to conceal previous errors, or, as the record argues, petitioner's judgment might have been made because in all the circumstances he believed that specific disclosure in the footnote was of little significance. But, under the district court's instructions and the ruling of the court of appeals, the jury might have concluded that the latter was the case and still have found petitioner guilty.

CONCLUSION

It cannot be, we submit, that if a professional is mistaken in objective terms concerning a question of materiality, he is necessarily criminally mistaken.

The petition for a writ of *certiorari* should be granted for the reasons therein and herein stated and the question herein stated should also be considered by the Court.

Dated: New York, New York
February 5, 1976

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APPENDIX

APPENDIX

• • •

In the context of this case I instruct you that a defendant may be found to have acted wilfully and knowingly only if he knew that a portion of the financial statements recited in count 2, such as the footnote or a figure entry, was false and misleading. It is not enough, in other words, merely to establish that a given defendant acted negligently or through error or mistake. Although mistakes or negligence may give rise to civil suits, they do not constitute criminal conduct.

A finding of an intention to include false and misleading information of a material nature is required. Good faith, that is to say, an honest belief in the truth of the data set forth in the footnote and entries in the proxy statement, would constitute a complete defense here.

I point out that the prosecution, however, is not required to prove the making of the alleged false or misleading data or the defendants knowing, intentionally participations therein by direct proof, that is to say, by direct eyewitness evidence or the like. These elements of knowledge and intent, in other words, may be proved by circumstantial evidence, that is to say, by such inferences as may naturally and reasonably be drawn from all of the facts and circumstances as shown by the evidence in the case.

While I have stated that negligence or mistake does not constitute guilty knowledge or intent, nevertheless, ladies and gentlemen, you are entitled to consider in determining whether a defendant acted with such intent if he deliberately closed his eyes to the obvious or to the facts that certainly would be observed or ascertained in the course of his accounting work or whether he reck-

lessly stated as facts matters of which he knew he was ignorant.

If you find such reckless deliberate indifference to or disregard for truth or falsity on the part of a given defendant, the law entitles you to infer therefrom that that defendant wilfully and knowingly filed or caused to be filed false financial information of a material nature with the SEC.

But such an inference, of course, must depend upon the weight and credibility extended to the evidence of reckless and indifferent, conduct, if any.

I repeat: Ordinary or simple negligence or mistake alone would be insufficient to support a finding of guilty knowledge or wilfulness or intent. (Tr. 2363-65.)

* * *

Now, I have been talking about material facts. You heard material facts being discussed by lawyers and witnesses during the trial. I want to define here for you what the law means about material facts.

Let me approach it for you in this way. In deciding whether a fact is material, ladies and gentlemen of the jury, you are entitled to consider whether it was the kind of information that a financial statement ordinarily contains in order to fulfill its function of fairly presenting the financial picture of the company for which it is filed.

A material fact can be simply defined as one that would matter to a reasonable person in deciding whether or not to purchase NSMC's stock, for example. That is to say, a fact, the validity of which would concern a reasonable person in making his purchase or investment decision.

Obviously a balance sheet or income statement is not supposed to contain all the information a creditor or po-

tential investor or stockholder might need or want to know in order to make informed judgments. The function of the financial statement is simply to present a basic summary of the company's financial position and operations and earnings for the time period stated.

Now, in this connection I point out to you, and I should have made this point earlier, but I think you understand it, no one is contending, and it certainly is not the fact, that an outside auditing firm such as PMM has responsibility for the operations or management of a company such as NSMC. An auditor must ascertain that the financial statement in question, such as the figures or the footnote, fairly presents the results of the operations and the financial position of the company. Also, as stated heretofore, in effect, an auditor must honestly believe that that financial statement or statements are neither false nor misleading in respect to material facts.

Perhaps the critical issue in this case, therefore, can be summarized as follows: Were the quoted earnings figures and footnote set forth in Count 2 fairly set out? That is to say, did they fairly present the revenue and earnings picture for NSMC for the fiscal year 1968 and the first nine months unaudited of fiscal 1969?

If you determine that there is nothing materially false or misleading about this information as alleged in Count 2, that would end your inquiry and you would be obliged to acquit both defendants.

On the other hand, should you find that the quoted material is substantially inaccurate and misleading in whole or in part, then you would have to turn your attention to each of the defendants to consider what the evidence shows that he did or failed to do and to determine whether or not he participated in a scheme to knowingly and inten-

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tionally permit the submission of earnings figures known to be false in a material way to the SEC in the proxy statement.

If you find that such a scheme has been proved and if you determine that there is some evidence that a given defendant participated in this you still have to ascertain, of course, that the prosecution has established beyond a reasonable doubt that the defendant under consideration knowingly and wilfully either put or caused to be put false or misleading material facts into that proxy statement or knowingly and wilfully assisted in this conduct with a realization of what was going on and a desire to participate in this scheme.

If you find that a given defendant participated simply through carelessness or negligence, with a mistaken but nevertheless honest belief that his participation was correct, truthful and sufficient, then you should acquit that defendant.

If, on the other hand, you find that the defendant in question knew that the false or misleading data of a material kind were being placed in the proxy statement and then knowingly and intentionally did something to assist in this course of action you should find that defendant guilty. (Tr. 2368-71.)

• • •

You also asked me to talk again about knowingly and wilfully, what the law means by those words or that phrase.

Of course, I talked a great deal about that in various portions of my charge or instructions. What I intend to do is read what I think you have in mind and then I will ask you again to make sure I have covered what it is that you wanted.

I am embarrassed to say that I rushed down without my glasses. If you will just be patient a minute, I will read I think a little bit better than I would without.

I think, however, I can begin, even though my law clerk is coming, I am sure. Let me repeat something. I will instruct you once again, as I did this morning, on what a material fact is conceived to be by the law.

Incidentally, you asked if it was possible that you get this in writing. Under our system that's not possible. I will be obliged to orally do it again.

Let me repeat what I said this morning. I said that in deciding whether a fact is material you are entitled to consider whether it is the kind of information that a financial statement ordinarily contains in order to fulfill its function of fairly presenting the financial information or data in regard to the company or corporation in question, in our case, of course, NSMC.

I also defined a material fact as follows:

A material fact can be simply defined as one that would matter to a reasonable person in deciding whether or not to purchase stock, such as shares of stock in NSMC, that is to say, a fact the validity of which would concern a reasonable person in making his purchase or investment decision about the company in question.

I went on to say that obviously a balance sheet or income statement or data is not supposed to contain all of the information a creditor or a potential investor or stockholder might want to know or see in order to make an informed judgment. The function of the financial statement or an income statement is simply to present a basic summary of the company's essential financial position and its operations and earnings for the time or period stated or in question. (Tr. 2396-97.)

• • •

Now, is there anything further that you would like repeated for you?

Juror No. 1: Wilful and knowingly.

The Court: All right. Very good.

I repeat what I said in substance this morning. In the context of this case, ladies and gentlemen, a defendant may be found to have acted wilfully and knowingly only if he knew that a portion of the financial statement, such as the footnote or the financial data entries there that are alleged in count 2, was false and misleading.

It is not enough to prove, in other words, that he was acting knowingly and wilfully if all the evidence establishes is that a defendant under question acted negligently or carelessly. I pointed out that although mistakes or negligence might give rise to a civil lawsuit, they do not constitute a sufficient basis for finding criminal or culpable conduct.

A finding of an intention to include false or misleading information of material nature is required here in order to find that a defendant acted wilfully and knowingly.

Good faith, that is to say, an honest belief in the trust of the data set forth in the footnote or the other entries which are alleged in count 2, would not be proof of any knowing and wilful intention to do something misleading in the way of setting up entries or footnotes in these financial statements and thus support a criminal conviction.

Now, it is true, ladies and gentlemen, that in a great many other portions of my charge I was in part talking about knowing and wilfully. But that is the sum and substance of it as I stated this morning. But again, I ask you, is there anyone or more of you who would like anything more either on this subject or on some other subject in this area, generally speaking?

Does that seem to be about it?

All right. Very good. You may retire once again and take up your deliberations. (Tr. 2400-01.)

• • •

Juror No. 1: Would you be kind enough and would it be in order to ask you to once again explain the term "knowing."

The Court: It certainly is very much in order and I would be more than happy to do that.

In the context of this case, ladies and gentlemen, a defendant may be found to have acted wilfully and knowingly only if he knew that a portion of the financial statement, such as a footnote or some other entry, was false and misleading. It is not enough merely to establish that a given defendant acted negligently or through error or mistake.

A finding of an intention to include false or misleading information of a material nature is required. Good faith, that is to say, an honest belief in the truth of the data set forth in the relevant footnote and entries in the proxy statement, would constitute a complete defense here.

In this connection, I point out to you that the prosecution is not required to prove the making of the alleged false or misleading statements or the defendants knowing and intentional participation therein by direct proof, that is to say, by direct eyewitness evidence or the like.

Such elements obviously may be proved by circumstantial evidence, by such inferences, in other words, as may naturally and reasonably be drawn from all of the facts and circumstances introduced into evidence.

While I have stated that negligence or mistake does not constitute guilty knowledge or intent, nonetheless, you are entitled to consider in determining whether a defendant acted with intent or knowingly if he deliberately closed his

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eyes to the obvious or to facts that certainly would be observed or ascertained in the course of his accounting work or whether he recklessly stated as facts matters of which he knew full well he was ignorant.

If you find such reckless deliberate indifference to or disregard for truth or falsity on the part of a defendant, the law entitles you to infer therefrom that that defendant wilfully and knowingly filed or caused to be filed false financial information with the SEC. But such an inference, of course, must depend upon the weight and credibility extended to the evidence of recklessness and indifference.

As stated, ordinary or simple negligence alone would be insufficient to support a finding of guilty knowledge or wilfulness. (Tr. 2426-27.)

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In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-808

ANTHONY M. NATELLI, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 527 F. 2d 311.[1]

JURISDICTION

The judgment of the court of appeals (Pet. App. B) was entered on July 28, 1975. A petition for rehearing was denied on November 5, 1975 (Pet. App. D). The petition for a writ of certiorari was filed on December 5, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] In its original opinion affirming petitioner's conviction, the court of appeals reversed the conviction of petitioner's co-defend-

(Continued)

QUESTIONS PRESENTED

1. Whether, in a prosecution of a certified public accountant for willfully and knowingly making false statements in audited and unaudited financial statements, the district court was required, notwithstanding evidence of extraordinarily suspicious circumstances surrounding the unaudited financial statement, to instruct the jury on what the accountant's normal professional obligation would be with respect to unaudited statements in the absence of such suspicious circumstances.

2. Whether the district court correctly instructed the jury that, if it found that petitioner "deliberately closed his eyes to the obvious" or acted with "reckless deliberate indifference to or disregard for truth or falsity," it could infer that petitioner acted willfully and knowingly.

3. Whether the district court's instructions adequately informed the jury that its verdict must be unanimous.

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ant, Joseph Scansaroli, and remanded his case for a new trial (Pet. App. 30a). The court thereafter granted the government's petition for rehearing and affirmed the conviction of Scansaroli (Pet. App. C). Subsequently, on Scansaroli's petition for rehearing, the panel withdrew its opinion on the government's petition for rehearing and reinstated its original opinion and judgment reversing Scansaroli's conviction. See the appendix to petitioner's supplemental brief. The government has filed a further petition for rehearing and suggestion for rehearing *en banc*, which is presently pending before the Second Circuit.

4. Whether the district court correctly denied a motion to dismiss the indictment on the ground of improper venue.

5. Whether the prosecutors withheld material evidence from and made affirmative misstatements to the jury.

STATEMENT

After a jury trial in the United States District Court for the Southern District of New York, petitioner was convicted of willfully and knowingly making and causing to be made false and misleading statements with respect to material facts in a proxy statement required to be filed with the Securities and Exchange Commission, in violation of Section 32(a) of the Securities Exchange Act of 1934, 48 Stat. 904, as amended, 15 U.S.C. 78ff(a).[2] Petitioner was sentenced to serve 60 days of a one year term of imprisonment, the balance to be served on probation, and he

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[2] 15 U.S.C. 78ff(a) provides in part:

"Any person who * * * willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both * * *."

was fined $10,000 (Pet. App. 3a). The court of appeals affirmed (Pet. App. A).[2]

Petitioner, a certified public accountant and a partner in the accounting firm of Peat, Marwick, Mitchell & Company ("Peat"), was the engagement partner for Peat's audits of the financial statements of National Student Marketing Corporation ("NSMC"). The indictment charged that petitioner participated with others in willfully and knowingly making two false statements of material facts in a proxy statement filed by NSMC with the Securities and Exchange Commission in connection with a special meeting of NSMC stockholders, held in the fall of 1969 to consider issuing additional shares of common stock and approving proposed mergers with other companies.

First, the proxy statement contained an audited statement of earnings for NSMC's fiscal year 1968. Some of the figures in the statement differed from those in a previous statement of earnings for the same year (also audited by petitioner) that had been contained in the company's annual report to its stockholders. The indictment alleged that a footnote pur-

[2] Petitioner's co-defendant at trial, Joseph Scansaroli, was also convicted of the same offense, but his conviction was ultimately reversed by the court of appeals (see note 1, *supra*). Four other defendants who were charged in the same indictment—Cortes W. Randell, Bernard J. Kurek, Dennis M. Kelly, and Robert C. Bushnell—pleaded guilty to one or more counts prior to the commencement of petitioner's trial. Another defendant, John G. Davies, was severed and subsequently pleaded guilty to one count of a superseding indictment.

porting to explain those differences was materially false and misleading because, as petitioner knew, it substantially overstated NSMC's net sales and profits for the period. Second, the proxy statement also contained an unaudited statement of NSMC's earnings for the first nine months of fiscal year 1969. The indictment alleged that figures in that statement, purporting to reflect net sales and net earnings, were materially false and misleading because, as petitioner knew, they substantially overstated each.

1. *The Footnote.* The evidence at trial, as summarized in the opinion of the court of appeals (Pet. App. 3a–12a), showed that, in his initial audit of NSMC's 1968 financial statements, petitioner certified, without adequate verification, the post-fiscal-year booking of approximately $1.7 million of unbilled NSMC sales on the basis of what were represented to be oral commitments to use NSMC marketing services. As a result, the company's audited statements, contained in the 1968 annual report, reflected a substantial profit instead of a loss. After the 1968 annual report was published and before the proxy statement at issue here was filed, "seven companies were acquired largely in exchange for [NSMC] stock, in reliance on the 1968 annual report" (Pet. App. 7a).

In the first six months following publication of the 1968 annual report, NSMC wrote off as "uncollectible" more than $1 million of the $1.7 million of unbilled sales that petitioner had allowed to be booked.

By an unorthodox procedure approved by petitioner, a large portion of the earnings attributable to the write-off (an ordinary item) was "netted" with an unrelated tax credit (an extraordinary item), and the tax credit was rounded off to make it identical to the write-off. As the court of appeals stated, "[t]he effect of the netting procedure was to bury the retroactive adjustment which should have shown a material decrease in earnings for the fiscal year ended August 31, 1968" (Pet. App. 8a–9a).

The audited statement of earnings for 1968 that appeared in the 1969 proxy statement reflected the combined operations of NSMC and the later-acquired (or "pooled") companies. An explanatory footnote was drafted to compare NSMC's separate sales and earnings for 1968, as originally reported in the 1968 annual report, with the consolidated figures for the same period, as reflected in the proxy statement.[4] As

[4] The footnote stated in relevant part (Pet. App. 4a, n. 2):

"Net sales and earnings as originally reported to stockholders in the annual report [for the year 1968] and the amounts as shown in the statement of earnings in this proxy statement are reconciled as follows:

"*Net sales:*	1968
Originally reported	$4,989,446
Pooled companies reflected retroactively	6,552,449
Per statement of earnings	$11,541,895

"*Net earnings:*	
Originally reported	$388,031
Pooled companies reflected retroactively	385,121
Per statement of earnings	$773,152"

the court of appeals stated, "[t]he footnote was the only place in the proxy statement which would have permitted an interested investor to see what [NSMC's] performance had been in its preceding fiscal year 1968, as retroactively adjusted, separate from the earnings and sales of the companies it had acquired in fiscal year 1969" (Pet. App. 9a).

Although most of the unbilled sales that had been booked for fiscal year 1968 had been written off by the time the proxy statement was prepared, that write-off was not reflected in NSMC's "net sales" figures shown in the footnote. Instead, at petitioner's direction, the amount of the write-off was improperly subtracted from the figure showing the net sales of the *acquired* companies. The footnote also did not reflect the reduction in NSMC's net earnings occasioned by the sales write-off.[5] An original draft of the footnote contained a partial narrative disclosure of certain contract losses, but that narrative disclosure was stricken by petitioner (Pet. App. 9a–10a).

2. *The Pontiac and Eastern "commitments."* The proxy statement also included unaudited financial statements for the first nine months of NSMC's fiscal year 1969. The statements as prepared by NSMC reflected an unbilled sale to the Pontiac Division of Gen-

[5] A large portion of the write-off had been "netted" with an extraordinary tax credit (see p. 6, *supra*). An additional reduction of $21,000 in NSMC's net earnings for 1968, attributable to other sales write-offs, was subtracted by petitioner from the figure showing the net earnings of the acquired companies rather than from the figure showing NSMC's net earnings (Govt. Exhs. 17 and 65–12).

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eral Motors in the amount of $1.2 million. Petitioner had indicated that he might not permit the Pontiac sale to remain on the books unless additional information were provided to show that there was a firm commitment (Tr. 653, 672; Natelli Exh. H).[6]

Petitioner, other Peat employees, and NSMC officials gathered in New York on the night of August 14, 1969, at the Pandick Press, which was to print the proxy statement the next day. At about 3:00 A.M. on August 15, petitioner told NSMC's president, Cortes Randell, that the Pontiac sale could not be included in the nine-month earnings statement. Randell responded that NSMC had an unbooked but firm commitment from Eastern Airlines in a comparable amount attributable to the same nine-month period (which had ended more than two months earlier). An NSMC salesman arrived at the printing plant several hours later with a letter from Eastern Airlines dated August 14, 1969, purporting to confirm an $820,000 oral commitment ostensibly made on May 14, 1969, two weeks before the end of the nine-month period (Pet. App. 10a–11a). The court of appeals stated (Pet. App. 15a–16a; footnote omitted):

> The Eastern contract was a matter for deep suspicion because it was substituted so rapidly

[6] The Pontiac sale had been booked as of February 28, 1969, the close of the first six months of NSMC's fiscal year 1969, although the letter purporting to evidence the sale was dated April 28, 1969, two months after the close of that period, and stated only that Pontiac was then "planning to implement * * * [NSMC] proposals that would result in gross billings of $1,200,000" (Govt. Exh. 12). The booking of the Pontiac sale occurred at approximately the same time as the write-off of $1 million of 1968 sales (see pp. 5–6, *supra*).

> for the Pontiac contract to which Natelli had objected, and which had, itself, been produced after the end of the fiscal period, though dated earlier. It was still another unbilled commitment produced by [NSMC] long after the close of the fiscal period. Its spectacular appearance, as Natelli himself noted at the time, made its replacement of the Pontiac contract "weird." The Eastern "commitment" was not only in substitution for the challenged Pontiac "commitment" but strangely close enough in amount to leave the projected earnings figures for the proxy statement relatively intact. [NSMC] had only time logs of a salesman relating to the making of the proposals but no record of expenditures on the Eastern "commitment," no record of having ever billed Eastern for services on this "sale," and not one scrap of paper from Eastern other than the suddenly-produced letter.

Petitioner ultimately concluded that the purported Eastern commitment should be booked. "When the proxy statement was printed in final form, the Pontiac 'sale' had been deleted [from the nine-months' earnings statement], but the Eastern 'commitment' had been inserted in its place" (Pet. App. 11a).

The day after the incident at Pandick Press, a Peat accountant working under petitioner's overall supervision discovered more than $177,000 worth of additional "bad" contracts that had been booked as unbilled receivables in fiscal year 1968 and that had not yet been written off. The accountant suggested to

NSMC's comptroller that these and other "questionable" contracts, together totaling about $320,000, be written off and that appropriate adjustments be made in the financial statements contained in the proxy statement (Tr. 745–760). The comptroller consulted with co-defendant Scansaroli (another Peat accountant working directly under petitioner); after consulting with petitioner, Scansaroli decided against the suggested write-offs and adjustments (Pet. App. 11a).

The proxy statement, as filed with the Securities and Exchange Commission on September 30, 1969, reflected, for the nine-month period ending May 31, 1969, consolidated net earnings of approximately $700,000 (Govt. Exh. 25, p. 21). As the court of appeals stated, "[a] true disclosure, which was not made, would have shown that without these unbilled receivables [NSMC] had no profit in the first nine months of [fiscal] 1969" (Pet. App. 11a).

ARGUMENT

1. Petitioner was charged with willfully and knowingly making false and misleading statements in audited and unaudited financial statements. He does not here challenge the sufficiency of the evidence to support his conviction. He contends that the district court should have instructed the jury "on the scope of an accountant's professional obligations when working with unaudited statements" (Pet. 26).

The court of appeals correctly held, however, that the instruction requested by petitioner on this point

"was not correct" and "was properly denied" by the district court (Pet. App. 24a). Petitioner does not challenge that holding, nor does he even now suggest what a proper instruction would have been. His contention is that, because the court "instruct[ed] the jury on an *auditor's* responsibility," it erred in failing "to add *any* remarks distinguishing *unaudited* statements" (Pet. 28, n. 17; emphasis in original). The contention rests on an inaccurate premise.

The district court instructed the jury that it could, in determining whether petitioner acted willfully and knowingly, consider whether he "followed or deviated from generally accepted auditing or accounting standards" (Tr. 2365). Rather than undertaking to formulate the governing standards, however, the court properly deferred to the jury's assessment of the "expert opinion evidence offered by various witnesses" (Tr. 2366). The few general references to the professional duties of an accountant were, for the most part, broadly applicable to unaudited as well as audited statements and did not outline in any detail the procedures generally followed in an audit.[7] The court's occasional

[7] The court stated that "a firm of public accountants, * * * engaged to perform an independent audit for a corporation such as NSMC, represents and warrants that it will perform the audit and other accounting work in accordance with generally accepted auditing and accounting principles, that it will render an opinion based upon its audit, for example, as to whether the financial statement of the company fairly presents its financial position and the results of its business operation" (Tr. 2367). The court also included the following remarks in its instructions: "[N]o one is contending, and it certainly is not the fact, that an outside auditing

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use of the word "auditor" in place of "accountant," to which no objection was made, does not support petitioner's assertion that the instructions "focused exclusively on auditing" (Pet. 28).

In any event, as the court of appeals correctly stated, the issue "is not what an auditor is *generally* under a duty to do with respect to an unaudited statement, but what these defendants had a duty to do in these unusual and highly suspicious circumstances" (Pet. App. 23a; emphasis in original). The court described that duty as follows (Pet. App. 16a–17a):

> It is common ground that the auditors were "associated" with the [nine-month earnings] statement and were required to object to anything they actually "knew" to be materially false. In the ordinary case involving an unaudited statement, the auditor would not be chargeable simply because he failed to discover the invalidity of booked accounts receivable, inasmuch as he had not undertaken an audit with verification. In this case, however, Natelli "knew" the history of [NSMC's] post-period bookings and the dismal consequences later discovered. Was he under a duty in these circumstances to object or to go beyond the usual scope of an accountant's review and insist upon some independent verification? The American Insti-

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firm such as PMM has responsibility for the operations or management of a company such as NSMC. An auditor must ascertain that the financial statement in question, such as the figures or the footnote, fairly presents the results of the operations and the financial position of the company. Also, * * * an auditor must honestly believe that that financial statement or statements are neither false nor misleading in respect to material facts" (Tr. 2369).

> tute of Certified Public Accountants, Statement of Auditing Standards No. 1—Codification of Auditing Standards and Procedures (1972), 1 CCH AICPA Professional Standards § 516.00, recognizes that "if the certified public accountant concludes on the basis of facts known to him that unaudited financial statements with which he may become associated are not in conformity with generally accepted accounting principles, *which include adequate disclosure,* he should insist . . . upon appropriate revision . . ." (emphasis added).
>
> We do not think this means, in terms of professional standards, that the accountant may shut his eyes in reckless disregard of his knowledge that highly suspicious figures, known to him to be suspicious, were being included in the unaudited earnings figures with which he was "associated" in the proxy statement.

The court of appeals correctly stated that, in the "unusual and highly suspicious circumstances" surrounding NSMC's effort to substitute the Eastern "sale" for the unacceptable Pontiac "sale," petitioner's duty "was not so different from the duty of an accountant upon an audit as to require sharply different treatment of that duty in the charge to the jury" (Pet. App. 23a). Indeed, Peat's own general outline of procedures to be followed by its accountants in reviewing certain unaudited financial statements is explicitly conditioned on the assumption that "there are no unusual circumstances that would require additional investigation to ascertain that the interim figures are not misleading" (Govt. Exh. 13, p. E101).

Contrary to petitioner's assertion, the court of appeals did not adopt "a theory of professional obligation * * * that compels accountants to ignore the distinction" between audited and unaudited financial statements (Pet. 26) or to "observe auditing procedures even when dealing with unaudited statements" (Pet. 28). As the court clearly stated (Pet. App. 24a):

> We expound no rule * * * that an accountant in reviewing an unaudited company statement is bound, without more, to seek verification and to apply auditing procedures. We lay no extra burden on the normal activities of accountants, nor do we assume the role of an Accounting Principles Board. We deal only with such deviations as fairly come within the common understanding of dishonest conduct which jurors bring into the box as applied to the particular conduct prohibited by the particular statute.

The court held only that, in the special circumstances of this case, the district court was not required to instruct the jury on "the abstract question of an accountant's responsibility for unaudited statements, for that was not the issue" (*ibid.*). Petitioner apparently recognized as much at trial, for, while he presented the testimony of six certified public accountants, not one of them testified concerning the nature of any procedural differences in an accountant's responsibility with respect to audited and unaudited financial statements.[8]

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[8] In his reply brief in the court of appeals, petitioner asserted that "the defense did elicit * * * proof," from witnesses other than petitioner's own experts, that there is a "distinction between * * *

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The issue is whether, in light of petitioner's prior experience with NSMC's post-period booking of unbilled (and ultimately uncollectible) "sales"—which in each instance resulted in the reporting of profits instead of losses—his failure to "insist upon some independent verification" (Pet. App. 16a) of the purported Eastern Airlines commitment could properly have been found by the jury to have amounted to "deliberately clos[ing] his eyes to the obvious" (Pet. App. 23a). Where, as here, the circumstances are extraordinarily suspicious, the scope of an accountant's duty in ordinary, non-suspicious circumstances is of minimal pertinence.

2. Petitioner contends that the district court erroneously permitted the jury to find him guilty of the offense charged in the indictment "without regard to his actual knowledge or belief" (Pet. 22) and that the court of appeals, in holding that "[i]t was sufficient * * * if petitioner had acted with 'reckless disregard' for the true facts" (*ibid.*), "eliminat[ed]

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outside accountants' duties with regard to audited and unaudited figures" (p. 33). But none of the testimony cited by petitioner—Tr. 305–306, 350, 792, 1534–1535—purports to describe these allegedly different duties. The general proposition, assented to by a government witness, that an accountant reviewing unaudited financial statements does not "do a complete check on the company's figures" (Tr. 306) provides no basis for the kind of instruction that petitioner contends was required. The one exhibit cited by petitioner—Govt. Exh. 13, a voluminous compilation of co-defendant Scansaroli's work papers—includes Peat's two-page general outline for the review of certain unaudited financial statements. To the extent that the outline bears on the present issue, its express condition, quoted above, supports our position, not petitioner's (see p. 13, *supra*).

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* * * the requirement of scienter" (Pet. 23) and thereby effected "a novel departure from the usual concepts of criminal culpability" (Pet. 30).

However, the issue thus posed, based upon an interpretation of some of the language in the court of appeals' opinion, is not actually presented in this case. Fairly read, the district court's instructions—which were in accord with a long line of Second Circuit decisions [9]—left no room for a conviction except on a finding that petitioner intentionally made false statements in the financial reports. The court instructed that, in order to return a verdict of guilty, the jury "must be satisfied beyond a reasonable doubt that the defendant in question acted willfully and knowingly" (Tr. 2361); that petitioner "may be found to have acted willfully and knowingly only if he knew that a portion of the financial statements * * *, such as the footnote or a figure entry, was false and misleading" (Tr. 2363); that "[i]t is not enough * * * merely to establish that a given defendant acted negligently or through error or mistake" (Tr. 2363–2364); and that "[g]ood faith, that is to say, an honest belief in the truth of the data set forth in the footnote and entries in the proxy statement, would constitute a complete defense here" (Tr. 2364).

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[9] See, *e.g.*, *United States* v. *White*, 124 F. 2d 181 (C.A. 2) (L. Hand, J.); *United States* v. *Benjamin*, 328 F. 2d 854, 862–863 (C.A. 2) (Friendly, C. J.), certiorari denied *sub nom. Howard* v. *United States*, 377 U.S. 953. The instructions in the present case were adapted, almost verbatim, from the charge given by then District Judge Mansfield in *United States* v. *Simon*, 425 F. 2d 796 (C.A. 2), certiorari denied, 397 U.S. 1006.

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The court also stated that, as with any other element of the offense, "[t]hese elements of knowledge and intent * * * may be proved by circumstantial evidence, that is to say, by such inferences as may naturally and reasonably be drawn from all of the facts and circumstances as shown by the evidence in the case" (*ibid.*). As an example of such a permissible inference, the court explained that, while "negligence or mistake does not constitute guilty knowledge or intent, * * * you are entitled to consider in determining whether a defendant acted with such intent if he deliberately closed his eyes to the obvious or to the facts that certainly would be observed or ascertained in the course of his accounting work or whether he recklessly stated as facts matters of which he knew he was ignorant" (Tr. 2364–2365). The court continued: "If you find such reckless deliberate indifference to or disregard for truth or falsity on the part of a given defendant, the law entitles you to infer therefrom that the defendant willfully and knowingly filed or caused to be filed false financial information of a material nature with the SEC. But such an inference, of course, must depend upon the weight and credibility extended to the evidence of reckless and indifferent conduct, if any" (Tr. 2365).[10]

[10] The court thereafter reiterated that the government must prove "beyond a reasonable doubt that the defendant under consideration knowingly and willfully either put or caused to be put false or misleading material facts into that proxy statement or knowingly and willfully assisted in this conduct with a realization of what was going on and a desire to participate in this scheme" (Tr. 2371). "If you find that a given defendant participated sim-

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These instructions, while properly permitting the jury to draw common sense inferences concerning guilty knowledge from pertinent circumstantial evidence, did not on any fair reading allow the jury to find petitioner guilty "without regard to his actual knowledge or belief" (Pet. 22). The court repeatedly stated, both before and after its discussion of the inferences that could be drawn concerning guilty knowledge, that the prosecution was required to prove beyond a reasonable doubt that petitioner acted willfully and knowingly.

Petitioner concedes that "the making of an erroneous statement in ignorance of the facts can be held criminal [under 15 U.S.C. 78ff(a)] * * * if the defendant has consciously closed his eyes to the truth" (Pet. 30). He argues that the district court should have told the jury *sua sponte* that, to infer guilty knowledge, it must find that petitioner had "a conscious purpose to avoid learning the truth" (Pet. 31).[11]

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ply through carelessness or negligence, with a mistaken but nevertheless honest belief that his participation was correct, truthful and sufficient, then you should acquit that defendant" (*ibid.*).

[11] Petitioner did not request an instruction containing the language that he now argues was necessary. He objected to the government's proposed instruction concerning knowledge and willfulness (which contained a clause on recklessness) on the ground that, because there was evidence that petitioner had *considered* the matter of substituting the Eastern Airlines sale for the Pontiac sale, "this is not a case of reckless disregard" (Tr. 2139). Following the court's charge, petitioner, "just to preserve my record," objected generally "to the charge on reckless disregard" (Tr. 2383). Similarly, following the court's rereading of that portion of the instructions at the jury's request, petitioner again objected to the "inclusion of the reckless disregard language in the charge, as I did

But the language used by the district court ("deliberately closed his eyes to the obvious"; "reckless deliberate indifference to or disregard for truth or falsity") "'mean[s] essentially the same thing'" as the language suggested by petitioner (Pet. App. 22a). *United States* v. *Sarantos*, 455 F. 2d 877, 882 (C.A. 2).[12] The district court was not required to use the precise words that petitioner now proposes.

Nothing in this Court's recent decision in *Ernst & Ernst* v. *Hochfelder*, No. 74–1042, decided March 30, 1976, casts doubt on the correctness of the result here. The Court there held that a private cause of action for damages will not lie under Section 10(b) of the Securities Exchange Act and SEC Rule 10b–5 "in the absence of any allegation of 'scienter'—intent to deceive, manipulate, or defraud" (slip op. 7). The Court rejected a reading of Section 10(b) that would have imposed liability for negligent conduct alone.

The issue in *Hochfelder* could not arise under Section 32(a), because that provision, unlike Section 10(b), contains an explicit scienter requirement: the indictment must allege and the jury must find beyond a reasonable doubt that the defendant "willfully and knowingly" made a false statement of a

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at the time it was given" (Tr. 2428–2429). To the extent that petitioner is now complaining of the failure to include the "conscious purpose" language suggested in his petition, his claim must be assessed under the plain error standard of Rule 52, Fed. R. Crim. P.

[12] *United States* v. *Bright*, 517 F. 2d 584 (C.A. 2), relied on by petitioner, is not to the contrary. The jury there was instructed that the defendant's knowledge that certain checks were stolen could be inferred from a reckless disregard for whether the checks were stolen *or* from a conscious effort on the defendant's part to avoid

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material fact. The instructions in the present case accordingly made clear that negligent or careless conduct was not a basis for conviction and that guilty knowledge and intent were an essential element of the crime.

For the same reason, this case does not present a question analogous to the one that the Court found it unnecessary to decide in *Hochfelder*—"whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b–5" (slip op. 7, n. 12)). It was the prosecution's theory throughout the trial that petitioner deliberately made the false statements with which he was charged in order to conceal NSMC's losses and his own prior errors. The district court did not instruct the jury—and the court of appeals did not hold—that "recklessness is * * * a form of intentional conduct for purposes of imposing [criminal] liability" (*ibid.*) under Section 32(a). On the contrary, the jury was instructed repeatedly that it could return a verdict of guilty only if it found beyond a reasonable doubt that petitioner acted "willfully and knowingly."

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learning the truth (517 F. 2d at 588). Contrary to petitioner's reading of the decision, the court of appeals did not reverse the conviction "because of the trial judge's failure to include the requirement of a 'conscious purpose' when instructing that a 'reckless disregard' for the truth would suffice to convict" (Pet. 32). Indeed, the court "assume[d] that the use of the disjunctive 'or' standing by itself would *not* require us to reverse" (517 F. 2d at 588; emphasis added). The reason for the reversal was that the district court failed to give a balancing instruction, specifically requested by defense counsel, that the jury should acquit if it found that the defendant actually believed that the checks were not stolen (*ibid.*). In the present case, the court of appeals, *relying* on its decision in *Bright*, correctly ruled that the district court gave "a balanced charge which made it clear that negligence or mistake would be insufficient to constitute guilty knowledge" (Pet. App. 21a).

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The court permitted the jury to take into account, in its consideration of petitioner's knowledge and intent, whether he "*deliberately* closed his eyes to the obvious" or "recklessly stated as facts matters of which he *knew* he was ignorant" (Tr. 2364–2365, 2427; emphasis added), and the jury was told that it could infer guilty knowledge and intent if it found that petitioner acted with "such reckless deliberate indifference to or disregard for truth or falsity" (Tr. 2365, 2427). But those remarks did not alter the express statutory requirement that the accused be found to have acted willfully and knowingly.

In the first place, when the district court's language is "viewed in the context of the overall charge" (*Cupp* v. *Naughten*, 414 U.S. 141, 147), it is apparent that the focus was on deliberateness rather than recklessness. The jury was told, in effect, that it could properly infer guilty knowledge if it found that petitioner had shielded himself from the truth in the face of highly suspicious circumstances. That is the standard that petitioner himself embraces in substance (Pet. 24–25, 30–32).

But even viewing the phrase "reckless deliberate indifference" "in artificial isolation" (*Cupp* v. *Naughten*, *supra*, 414 U.S. at 147), and even indulging a narrower focus solely upon the word "reckless," the instructions still could not fairly be characterized as equating reckless conduct with willful and knowing conduct. It would be one thing to instruct a jury that it may return a verdict of guilty if it finds beyond a reasonable doubt that the defendant acted recklessly.

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It is quite another thing to instruct the jury that it *may*, if it finds that the defendant acted recklessly, draw an inference from that finding ("depend[ing] upon the weight and credibility extended to the evidence of reckless and indifferent conduct" (Tr. 2365)) that the defendant acted willfully and knowingly, but that it may return a verdict of guilty only if it finds beyond a reasonable doubt, in light of all the evidence, that the defendant in fact acted willfully and knowingly.

In the one case, recklessness would *be* the standard of culpability. In the other case, as here, reckless conduct would be simply one of the many facts from which the jury might infer guilty knowledge and intent, but the standard of culpability would remain willful and knowing conduct.

3. The district court charged the jury that it could return a guilty verdict if it found that the proxy statement was false in either of the two respects alleged in the indictment.[13] The court also told the

[13] The court stated (Tr. 2340–2341):

"Now, I instruct you that if you find that the proxy statement was false in either one of these two respects, that is sufficient to support a conviction. Put differently the Government isn't required in order to support a conviction here to prove that both parts or both false and misleading statements, so called, of material facts were such in order to support a conviction.

"* * * [T]he issue which you really have to focus on here can be stated in a relatively simple fashion: Did the defendants or either one of them knowingly and intentionally either prepare and submit material misstatements as to the financial position or financial operations for NSMC for the year of 1968, for which the figures were stated to be audited, or in respect to the figures for NSMC for the first nine months of 1969, which were, as I recall the proxy statement, labeled as unaudited figures.

jury that its verdict with respect to each defendant must be unanimous (Tr. 2380). At the close of the instructions, petitioner asked the court to add that the jury "must be unanimous as to which statement is false" (Tr. 2384). The court responded: "I think that's clear from what I have already said and I won't say anymore about that" (*ibid.*).

Petitioner argues that "[t]he failure of the trial court to give the requested charge created a substantial risk that the requirement of unanimity was not satisfied; the jurors might have agreed that the government had proved *one* specification of the indictment beyond a reasonable doubt, but disagreed as to which" (Pet. 34). The contention was correctly answered by the court of appeals (Pet. App. 26a; footnote omitted):

> The charge given by Judge Tyler is a charge generally given in this circuit. It is assumed that a general instruction on the requirement of unanimity suffices to instruct the jury that they must be unanimous on whatever specifications

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"If you were to determine that in neither one of the two respects alleged the statements were false or misleading, why, then, of course, you would be obliged to acquit both defendants.

"On the other hand, if you were to determine that in either or both respects the financial information or data or figures were in fact false and misleading in a material sense, then you would be obliged to consider whether or not the defendants knowingly participated in making these figures and putting them in the proxy statement to be filed with the SEC, and if you did find that they either knowingly made these misstatements or they caused them to be made or they aided and abetted in their making, then you woul be obliged to convict the defendant or defendants for which you make these findings."

> they find to be the predicate of the guilty verdict. We do not say it would be wrong for a trial judge to give the charge requested, but it is not error to refuse it. And we do not change that rule.

See also *Vitello* v. *United States*, 425 F. 2d 416, 422–423 (C.A. 9), certiorari denied, 400 U.S. 822; *United States* v. *Armone*, 363 F. 2d 385, 398 (C.A. 2), certiorari denied, 385 U.S. 957. The issue does not merit further review by this Court.

4. Section 32(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78ff(a), makes it a criminal offense willfully and knowingly to make a false statement in a document required to be filed with the Securities and Exchange Commission. Section 27 of the Act, 15 U.S.C. 78aa, provides that "[a]ny criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred." Petitioner argues that, because the proxy statement containing the false statements was filed with the Securities and Exchange Commission at its offices in Washington, D.C., "venue properly lay only in the District of Columbia" (Pet. 36) and the district court therefore erroneously denied his motion to dismiss the indictment returned in the Southern District of New York.

Petitioner does not deny, however, that the false statements contained in the proxy statement were prepared by him at least in part in the Southern District of New York (*ibid.*). It seems obvious to us, as it did to the courts below, that the preparation of a false statement to be included in a document filed with the

Securities and Exchange Commission is, within the meaning of Section 27, an "act or transaction constituting the violation" of Section 32(a). The lower federal courts have consistently held in similar cases involving the filing of false statements in violation of federal statutes that, under 18 U.S.C. 3237(a),[14] venue properly lies in the district where the false statements are prepared as well as in the district where they are filed.[15] See *United States* v. *Slutsky*, 487 F. 2d 832, 838–839 (C.A. 2), certiorari denied, 416 U.S. 937; *United States* v. *Bithoney*, 472 F. 2d 16, 21–24 (C.A. 2), certiorari denied, 412 U.S. 938; *United States* v. *Raekrap*, 333 F. 2d 641 (C.A. 7), certiorari denied, 379 U.S. 903; *Imperial Meat Co.* v. *United States*, 316 F. 2d 435, 440 (C.A. 10), certiorari denied, 375 U.S. 820; *Henslee* v. *United States*, 262 F. 2d 750 (C.A. 5), certiorari denied, 359 U.S. 984.

Travis v. *United States*, 364 U.S. 631, on which petitioner relies, does not require a different result here. That case involved a prosecution under 18 U.S.C. 1001, which proscribes the making of false statements "in any matter within the jurisdiction of

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[14] That section provides in part: "Except as otherwise expressly provided by enactment of Congress, any offense against the United States begun in one district and completed in another, or committed in more than one district, may be inquired of and prosecuted in any district in which such offense was begun, continued, or completed."

[15] The court of appeals had no occasion to consider whether petitioner could have been tried in the District of Columbia as well as in the Southern District of New York. Petitioner made no motion for a change of venue for the convenience of the parties, pursuant to the provisions of Rule 21(b), Fed. R. Crim. P.

any department or agency of the United States." The decision turned on the interaction of that provision and a section of the National Labor Relations Act, under which the Board's "jurisdiction" did not attach until the false statements at issue—non-Communist affidavits of union officers—had been filed. Recognizing that "[t]he decisions are discrete, each looking to the nature of the crime charged," and that venue determinations depend upon "the phrasing of a particular criminal statute" (364 U.S. at 635), the Court concluded, in view of the unusual "statutory design" (*ibid.*), that Congress intended the locus of the offense, and therefore the venue for a prosecution, to be exclusively in the District of Columbia, where the Board is located.

As the court of appeals correctly held, the statutory design here is materially different from that in *Travis,* and the particular result there does not control the venue determination here. Indeed, the Court in *Travis* stated that, if the National Labor Relations Act had required union officers to file non-Communist affidavits instead of merely conditioning the Board's jurisdiction upon such filings, "the whole process of filing, including the use of the mails, might logically be construed to constitute the offense" (364 U.S. at 635). This, of course, is not a prosecution under 18 U.S.C. 1001, but even if it were, the situation here would be like the one hypothesized by the Court in *Travis.* The filing of the proxy statement, while required as a condition precedent to the soliciting of proxies, was not required as a condition precedent to

the Securities and Exchange Commission's jurisdiction over the solicitation process.[16]

5. It was the government's contention at trial that the Eastern "commitment" that petitioner allowed to be booked retroactively as a sale by NSMC for the nine-month period ending May 31, 1969, and allowed to be included in the company's unaudited statement of earnings for that period in the proxy statement was an obvious fabrication designed to compensate for the deletion of the large Pontiac commitment. We maintain that position.

The evidence at petitioner's trial established that officials responsible for the financial affairs of NSMC had no knowledge of a large ($820,000) commitment on the part of Eastern Airlines to use the services of NSMC, until the "commitment" letter was first mentioned at the Pandick Press in the early morning hours on August 15, 1969, by other NSMC officials (Tr. 259, 654–655). Yet, the Eastern letter of August 14 purported to confirm an oral commitment given three months earlier. NSMC had never recorded any expenditures on the Eastern "contract" and had never billed Eastern for any services, nor was there any

[16] The decision here does not conflict with *Investors Funding Corp.* v. *Jones*, 495 F. 2d 1000 (C.A.D.C.). In that case, a civil action was brought against the defendant corporations by the Securities and Exchange Commission for injunctive relief to compel the defendants to comply in a timely fashion with certain filing requirements of the Securities Exchange Act. The court of appeals ruled that "venue for civil enforcement actions of the Commission, involving reports required to be filed in the District of Columbia, is here," because "the *locus* for the act of late filing" is in the District of Columbia (495 F. 2d at 1003). That conclusion

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documentation to indicate Eastern's interest in NSMC's services other than the suddenly produced "commitment letter" (Tr. 572, 1149–1150). Moreover, the Eastern letter was produced as a substitute for the Pontiac commitment, which petitioner had refused to include in the nine-month statement. Petitioner himself, in a handwritten memo, described the proposed substitution as "really weird" (Govt. Exh. 21).

In closing argument, the prosecutor suggested to the jury that the evidence showed that the "Eastern contract was known to be a complete phony when it came up" suddenly at 3:00 A.M. at the Pandick Press (Tr. 2295). Petitioner does not claim that the remark unfairly characterized the evidence. He contends, however, that subsequent testimony by NSMC's president (Randell), appearing as a government witness in a later trial of Eastern's employee (Mullen),[17] "demonstrates clearly that the prosecutor misstated the facts at petitioner's trial when he made the inflammatory argument to the jury that the Eastern commitment

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follows from the proposition that, in actions for *failure* to make required filings, venue lies in the district where the documents are required to be filed. See *United States* v. *Lombardo*, 241 U.S. 73. "In such a [case] it is difficult to see how the defendant does anything at all except at the place where he fails to file" (*Travis* v. *United States*, *supra*, 364 U.S. at 639 (dissenting opinion of Mr. Justice Harlan)). That rationale has no application to a case in which a false statement is made and filed as part of a continuing offense, begun in one district and completed in another.

[17] Mullen, who signed the Eastern "commitment" letter, was convicted of perjuring himself when he told the grand jury investigating NSMC that he never received anything of value from anyone at NSMC, whereas in fact, shortly after signing the "commitment" letter, he received from Randell several thousand shares of NSMC stock, followed by $25,000 in cash.

was a mythical construct that had first appeared 'by magic [at] 3 o'clock in the morning' and that no responsible NSMC official had previously 'peeped a word' concerning it" (Pet. 42). Petitioner also asserts that these alleged "misstatements were deliberate" (*ibid.*) and that evidence in the prosecutor's possession at the time of trial "directly contradicted * * * the version of key facts the government urged upon the jury" (Pet. 43).

We deny each of these assertions. The excerpts of Randell's testimony quoted by petitioner, even viewed solely on their face, indicate no more than that Randell had been told that an Eastern Airlines employee (Mullen) had agreed in May to go ahead with an NSMC program. There is no suggestion in the quoted testimony that *petitioner* had been aware of Eastern's alleged plans. What Randell may or may not have been told in no way bears on petitioner's state of mind.

Moreover, petitioner omits Randell's further testimony in the Mullen trial that Mullen's plans did not amount to a commitment by Eastern Airlines (Tr. 52–53, *United States* v. *Mullen* (S.D. N.Y., 74 Crim. 172)):

> Q. To your knowledge was there any commitment, oral or written, from Thomas Mullen or Eastern Airlines to spend $820,000 with National Student Marketing Corporation in existence as of May 14, [1969]?
>
> A. Not from Eastern. Tom [Mullen] said he wanted to do the program, but other than he, I knew of no commitment from anybody else, no.

Other evidence in the same trial demonstrates that Mullen had no authority to make any commitment on behalf of his employer, Eastern Airlines (*id.* at 310–324).

In sum, nothing in Randell's subsequent testimony supports petitioner's serious accusation that the prosecutor "withh[eld] from the jury the complete account of the Eastern contract and affirmatively misstat[ed] the actual facts in counsel's argument" (Pet. 45).

In any event, petitioner's contentions concerning the import of Randell's later testimony were not presented in his brief in the court of appeals. Randell's testimony was given on October 14, 1975, when petitioner's rehearing petition was pending in the court of appeals. On October 28, 1975, in a letter addressed to the panel of judges who decided the appeal, petitioner made essentially the same argument that he makes here. The court of appeals thereafter denied rehearing without opinion (Pet. App. D).

Whatever the merit of petitioner's allegations of prosecutorial misconduct, they obviously are not suited for resolution by this Court in the first instance. The proper procedure is for petitioner to present his contentions to the district court in a motion for a new trial under Rule 33, Fed. R. Crim. P., or a motion to vacate his sentence under 28 U.S.C. 2255. A denial of certiorari would not preclude his following either of those paths.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1976.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-808

ANTHONY M. NATELLI,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

The Government filed its Brief in Opposition to the petition for certiorari on April 9, 1976.[1] Petitioner submits this brief to reply to the government, to discuss the impact on his case of this Court's recent decision in *Ernst & Ernst v. Hochfelder*, ____ U.S. ____ (No. 74-1042, March 30, 1976) and to bring to this Court's attention a recent *en banc* decision of the Court of Appeals for the Ninth Circuit having an important bearing upon petitioner's point II. Petitioner's argument

[1] As noted in the government's brief, the government has filed a second petition for rehearing of the decision by the court of appeals to reverse the conviction of petitioner's codefendant. That pending rehearing petition refers to this prosecution as an "important case" that has attracted public attention.

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is organized under the five points presented in the petition for certiorari.[2]

We also emphasize at the outset that the American Institute of Certified Public Accountants (AICPA) and Peat, Marwick, Mitchell & Co. (PMM), one of the largest international firms of certified public accountants, have filed *amicus curiae* briefs urging the grant of certiorari because of the general importance of the issues raised by this case to the accounting profession.

[2] The government's statement of the facts relies heavily upon the opinion below. We have already noted in the petition the instances in which the court below departed from what the jury could fairly have found. (Pet. 5, 7 n.3, 10 n.5, 14 n.7, 18 n.9). Since the petition contains a detailed statement fairly presenting the facts developed at trial, we will not attempt to respond to each characterization of the facts in the government's brief that we consider erroneous or misleading, except as these bear significantly on the argument. *See, e.g.*, on the Eastern commitment, point V, *infra*.

We do note, however, two egregious statements made by the government about the footnote to the audited financial statements. The government implies that petitioner struck from an original draft of the footnote a narrative disclosure of contract write-offs drafted by someone else. (Br. in Opp., p. 7). The record shows, however, that it was petitioner himself who drafted the disclosure and he took it out only after discussing the matter with a PMM SEC reviewing partner who agreed that such disclosure was unnecessary. (Pet. 13-14).

Equally misleading is the government's characterization of the netting of contract write-offs and a tax credit as an "unorthodox procedure." (Br. in Opp., pp. 6-7 n.5.) In fact, the tax credit was shown separately in the financial statement printed in the proxy materials and was netted with the contract write-off only on NSMC's books, not in any public documents. This is a procedure used by professional accountants in entering off-setting items on a company's books (Tr. 665) and, of course, the use of the procedure was fully known in this case to the company's accountants and officers responsible for financial records.

I.

THE DECISION BELOW OBLITERATES THE ACCEPTED DISTINCTION BETWEEN AUDITED AND UNAUDITED STATEMENTS.

A. We argued in the Petition (Pet. 25-29) that this Court should review the determination by the court of appeals that an accountant may suffer criminal liability for failure to confirm unaudited figures, even though authoritative professional standards now adopted by SEC Accounting Rule 2-02(e) do not require confirmation or any other auditing procedures when an accountant is merely associated with an *unaudited* statement. Petitioner specifically requested an instruction making clear than an accountant's obligations regarding unaudited statements with which he becomes associated are far more limited than those he assumes when he renders an auditor's report.[3] Although the judge charged the jury on the responsibilities of an auditor, the language petitioner requested was not given. The court of appeals held that petitioner's request "was not correct" because the auditor's duty was "not so different" from that of an accountant associated with unaudited statements the court believed "suspicious." (Pet. App. 23a-24a).

[3]Petitioner's request included the following language:

> As to the unaudited statement of earnings for the nine months ended May 31, 1969, the defendants had no responsibility to render an opinion that the statement fairly presented the results of the client's operations. The defendants' only responsibility as to this statement was to be satisfied that, as far as they knew, the statement contained no misstatement of material facts.

The government contends that "[p]etitioner does not challenge [the court of appeals'] holding, nor does he even now suggest what a proper instruction would have been." (Br. in Opp. p. 11). The government has misstated petitioner's position and overlooked the requests made by petitioner's counsel.

The substance of petitioner's request-to-charge was taken from the pertinent provisions of the AICPA Statement of Auditing Standards No. 1, which state that an accountant "has no responsibility to apply *any* auditing procedures to unaudited financial statements" and that his obligations arise only if he "concludes *on the basis of facts known to him* that unaudited financial statements . . . are not in conformity to generally accepted accounting principles . . . ." §§ 516.02, 516.06 [emphasis added]. The court of appeals rejected this statement of an accountant's obligation and concluded that, under federal criminal law, the accountant's duty regarding unaudited statements may go "further," ultimately to be defined by a lay jury's "common understanding" of proper conduct. (Pet. App. 24a).[4]

Petitioner contends here, as he consistently has, that his obligations respecting the unaudited statement of

[4]The government implies that a PMM internal memorandum introduced at trial goes beyond the AICPA standards. (Br. in Opp., p. 13) The fact is, however, that petitioner satisfied the standards of his firm by examining NMSC records prior to concluding that he would not object to inclusion of Eastern figures in the unaudited statement. These records included the Eastern commitment letter, the time records of the account executive, and the detailed proposal NMSC had prepared for Eastern. See p. 23, *infra*. Nothing in the PMM internal memorandum purported to require the independent *verification* of unaudited data — the "next step" which the court below expressly held petitioner should have taken. (Pet. App. 22a-23a) In any event, the issue here is not the proper interpretation of PMM's memorandum, but whether an accountant following the authoritative AICPA statement of an accountant's obligations can nevertheless be convicted of a federal felony.

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earnings were those commanded by the authoritative professional pronouncements upon which the requested instruction was based. It is the court of appeals' express departure from those standards that petitioner asks this Court to review.

B. The government contends that the trial judge did not undertake to "formulate the governing standards" but properly left these for the jury to discern from expert testimony. (Br. in Opp., p. 11.) But the accountant's obligations when associated with unaudited statements involve a question of law, not a matter for an evidentiary contest among experts,[5] and in this case no expert testimony was offered.[6]

In any event the trial judge *did* purport to "formulate the governing standards" but in doing so referred only to an auditor's responsibilities. The judge then explained:

> Generally, as you have been told, in effect, a firm of public accountants, such as Peat, Marwick & Mitchell, *engaged to perform an independent audit* for a corporation such as NSMC, *represents and warrants* that it will perform the *audit* and other accounting work in accordance with generally accepted *auditing* and accounting principles, that it will *render an opinion based upon its audit*, for example, as to whether the financial statement of the company fairly presents its financial position and the results of its business operation. (Tr. 2367) [Emphasis added].

Thereafter, in explaining the meaning of financial statements, he added:

[5]The distinction between audited and unaudited statements has been consistently recognized in the lower federal courts *see, e.g., Fischer v. Kletz*, 266 F. Supp. 180 (S.D.N.Y. 1967); *Gold v. DCI, Inc.*, 1973 CCH Fed. Sec. L. Rep. ¶94,036 (S.D.N.Y. 1973) and the distinction is embodied in SEC Accounting Rule 2-02(e), 4 Fed. Sec. L. Rep. ¶68,128A (1976), which requires accountants to observe "appropriate professional standards" when associated with unaudited statements.

[6]The government offered no expert testimony on the

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> An *auditor must ascertain* that the financial statement in question, such as the figures or the footnote, *fairly presents the results of the operations and the financial position of the company*. (Tr. 2369) [Emphasis added].

But under the standards of the accounting profession this statement of an auditor's affirmative duties to inquire, to consider and to give his opinion was not relevant to petitioner's obligations respecting the *unaudited* figures reflecting the Eastern commitment. The repeated reference to the auditing function, without *any* counterbalancing instruction distinguishing the much more limited obligations attending association with unaudited statements, left the clear impression that the two kinds of obligations were the same.[7]

C. The government makes light of petitioner's contention that the decision below means that independent accountants will act at their peril if they

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obligations of accountants associated with unaudited statements, and the six CPA's called by the defense (cited in Br. in Opp., p. 14 n.8) testified only as to factual matters. In asserting that testimony elicited by the defense on this point was insufficient, the government ignores the fact that the burden of proving a departure from accepted accounting standards falls upon the government, not petitioner.

[7]The trial judge refused petitioner's request for an instruction distinguishing unaudited statements, not because he considered the request improper, but because he thought he had already made the distinction "about 16 times." (Tr. 2384). The judge was mistaken. After reading the indictment, he referred to the unaudited character of the nine-month earnings statement only once:

> Perhaps the critical issue in this case, therefore, can be summarized as follows: Were the quoted earnings figures and footnote set forth in Count 2 fairly set out? That is to say, did they fairly present the revenue and earnings picture for NSMC for the fiscal year 1968 and the first nine months unaudited of fiscal 1969? (Tr. 2369).

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continue to observe the distinction between audited and unaudited statements embodied in professional standards and the SEC rules. (Br. in Opp., p. 14). Yet it is difficult to see how any other effect can follow from a decision that permits lay jurors, who are instructed only on an auditor's responsibilities, to conclude from their "common understanding" that an accountant should have conducted independent verification – an auditing procedure – when associated with unaudited figures the jurors deem "suspicious". Indeed, the American Institute of Certified Public Accountants (AICPA) has filed an *amicus curiae* brief with this Court urging review because of the consequences the accounting profession itself sees as flowing from the decision below.

The auditor's distinct obligations in connection with the opinion he must render are reflected, as this Court has recently observed, in express language of the SEC rules. *Ernst & Ernst v. Hochfelder*, ____ U.S. ____ (No. 74-1042, March 30, 1976) slip op. at 1-2 n.1. The same SEC rule that defines the content of the auditor's report and opinion expressly distinguishes association with unaudited financial statements and as to these simply directs the accountant to observe "appropriate professional standards." *See* Accounting Rule 2-02(e), as amended September 10, 1975, 4 Fed. Sec. L. Rep. ¶69,128A (1976).[8] The holding of the court of appeals that an accountant like petitioner can properly be convicted of a felony for failure to confirm figures

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This summary followed the passage quoted in the text which focused exclusively upon the *auditor's* function, and suggested that the accountant was under identical obligations as to both the audited and unaudited figures.

[8] Subsections (b) and (c) of Accounting Rule 2-02, 4 Fed. Sec. L. Rep. ¶69, 127-69, 128 (1976), which concern the *auditor's* report and opinion, are identical to the subsections (i)(2) and (3) of current Rule 17a-5, 3 Fed. Sec. L. Rep. ¶26,982 (1976), which this Court cited in *Hochfelder*.

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appearing in unaudited statements marks an unforeshadowed departure from those governing professional standards adopted by the SEC's own rules and should be reviewed by this Court.

II.

THE DECISION BELOW SIGNIFICANTLY WEAKENS THE SCIENTER REQUIREMENT UNDER SECTION 32(a) OF THE SECURITIES EXCHANGE ACT.

A. We argued in the petition that conviction for knowingly and willfully filing a false financial statement ordinarily requires a finding that the defendant actually knew of the falsehood alleged. We also took note of authority in some courts of appeals that knowledge may be imputed to a defendant actually ignorant of the facts, but only where he acted with a *conscious purpose* to avoid enlightenment. In a recent *en banc* decision the Court of Appeals for the Ninth Circuit divided on the question whether knowledge may *ever* be imputed to a defendant charged under a statute punishing "knowing" conduct. *United States v. Jewell*, ____ F.2d ____ (9th Cir. No. 74-2832, February 27, 1976) (*en banc*).[9] A majority of the court concluded that a defendant might be treated as having actual knowledge if it were found that, notwithstanding his ignorance, he had "deliberately avoided positive knowledge . . . to avoid responsi-

[9]The offenses charged were "knowing" importation of a controlled substance, 21 U.S.C. §952(a), and "knowing" possession with intent to distribute, 21 U.S.C. §841(a)(1).

bility in the event of discovery."[10] *United States v. Jewell, supra,* slip op. at 3. The four dissenting judges believed that nothing short of actual knowledge would support conviction. Slip op. at 17-19. Petitioner, however, was convicted on a theory of reckless omission that no federal court has previously found equivalent to "knowing" and "willful" conduct.[11] The court of appeals sustained his conviction by holding that a professional duty to inquire existed, even as to unaudited figures, and that the breach of this duty was tantamount to knowledge.

B. The government contends that the instructions "left no room for a conviction except on a finding that

[10]The court reviewed various formulations of the concept of ignorance contrived for the very purpose of avoiding criminal responsibility. As the court noted, the requirement of a "conscious purpose to avoid learning the truth" has been the most common formulation. Slip op. at 7-9 & nn.12-13. As noted in the petition (Pet. 30-32 & n.18), this has been the uniform interpretation of other federal statutes proscribing "knowing" conduct. This Court has captured the same notion in its observation that one who practices a "studied ignorance" is not entitled to claim lack of knowledge. *Turner v. United States,* 396 U.S. 398, 417 & n.34 (1970), *citing Griego v. United States,* 298 F.2d 845, 849 (10th Cir. 1962) (adopting "conscious purpose" language).

[11]The government suggests that, in objecting to the charge on knowledge and intent, petitioner is asking for *sua sponte* action by the trial judge because of counsel's failure specifically to request inclusion of the "conscious purpose" language. (Br. in Opp., p. 18). During the conference between counsel and the trial judge on requests to charge, the judge indicated that he would include language on recklessness, as the government requested. Petitioner's counsel objected, arguing that the evidence did not support a recklessness charge. The judge dismissed his objection, saying his instructions would permit the government

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petitioner intentionally made false statements in the financial reports." (Br. in Opp., p. 16). This attempt to avoid the recklessness issue must fail because it is contrary to the demonstrable understanding of the jury, contrary to express acknowledgment of the trial judge who gave the charge, and contrary to the reading of it adopted by the appellate judges who affirmed the conviction.

Although, as the government notes, the words "willfully" and "knowingly" were frequently repeated in the charge (Br. in Opp., pp. 16-17), these words were defined in a discrete portion of the charge, in which the jury was told that it could convict petitioner if it found that he acted with reckless indifference to truth or falsity. (Tr. 2364-2365).

After the initial period of deliberation, the jury requested additional instruction on the definition of "wilful [sic] and knowingly." (Tr. 2400). In responding

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to argue that petitioner "should have been very skeptical about the [Eastern Airlines] contract." (Tr. 2139). Petitioner's counsel renewed his objection to the charge on recklessness after the jury retired (Tr. 2383) and again when recklessness was reintroduced in the second supplementary charge (Tr. 2428).

The nature of counsel's objection was clear to the trial judge, as indicated by his remark in overruling it, and under these circumstances counsel's conduct was adequate to preserve objections for appellate review. In any case, it is settled law that the failure to instruct the jury properly on the elements of intent and knowledge constitutes plain error. *See, e.g., United States v. Vitiello*, 363 F.2d 240, 243 (3rd Cir. 1966); *United States v. Alsondo*, 486 F.2d 1339, 1344 (2d Cir. 1973), *rev'd on other grounds sub nom. United States v. Feola*, 420 U.S. 671 (1975).

Most critically, the court below obviously found petitioner's objections to the charge properly before it and passed on them. (Pet. App. 20a-23a).

to that request the trial judge omitted any reference to recklessness as a basis for conviction, despite objection by the government. (Tr. 2400-2401). After another period of deliberations, the jury reported deadlock. (Tr. 2420).

The judge instructed the jury to continue deliberations and at the jury's second request again defined the requisite state of mind for conviction, but on this occasion the judge returned to the formulation of recklessness used at the close of all the evidence. (Tr. 2426-2427). Shortly thereafter the jury returned its verdict.

In discussing the concept of recklessness the judge charged that the jury could convict if it found that petitioner had "deliberately closed his eyes to the obvious or to facts that certainly would be observed or ascertained in the course of his accounting work . . . ." (Tr. 2427). Reintroduced after its omission in the first supplementary charge, this language permitted the jury to impute to petitioner the knowledge of facts that "would be" observed in the course of accounting work and to convict if it found a "reckless" failure to ascertain the truth. This interpretation was reinforced by the judge's concluding admonition that "*ordinary* or *simple* negligence *alone* would be insufficient" (Tr. 2427, emphasis added). This was the last language the jury heard before delivering its verdict. These instructions left the clear impression that the jury could convict upon finding a grossly negligent or reckless failure to make further inquiry.[12]

[12]This interpretation was intended by the trial judge, for at the conference with counsel on requests to charge, the judge stated, in response to objection to recklessness language, that his charge would permit the government to argue that petitioner "should have been very skeptical about the [Eastern] contract." (Tr. 2139).

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Clearly, the only realistic interpretation of the jury's conduct is that agreement on the requisite mental state—a matter that had obviously been a troublesome point from the beginning of deliberations—became possible only when the *second* supplementary instructions removed the need for a finding of actual knowledge, a finding that all jurors had been unable to make when told in the *first* supplementary charge that only actual knowledge would justify conviction.

Indeed, the trial judge expressly acknowledged the impact of his instructions on recklessness. At sentencing the judge expressed his belief that petitioner had been sincere in denying he had knowingly violated the law, but he added:

> "[T]he tragedy is that the jury found that this was an audit or audits done with reckless disregard for what was really involved. We know that because of the record showing what it did in the jury deliberation." (S. Tr. 12).

The trial judge thus appreciated that he had allowed the jury to return the conviction on the basis of a finding that the petitioner had recklessly failed to realize "what was really involved," and that this was all the jury

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The charge in *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969), *cert. denied* 397 U.S. 1006 (1970), cited by the government (Br. in Opp., p. 16 n.9) included the express admonition on three separate occasions that the jury must find knowing concealment with "intent to defraud" in order to convict. (*Simon* Tr. 4017, 4028-29, 4045). In arguing that the charge to petitioner's jury was "adapted almost verbatim" from that in *Simon*, the government neglects to point out that this key language from the *Simon* charge was not given.

had actually found, not that petitioner had actually known, or had consciously avoided learning, the true facts.

In view of this record, it is no surprise that the court of appeals considered petitioner's objections to the "recklessness" charge on the merits. The court flatly held that the conviction was proper without a finding of actual knowledge or a conscious purpose to remain ignorant. It did so because of its theory that petitioner had recklessly breached a purported duty of inquiry with respect to unaudited financial statements. (Pet. App. 16a-17a; 22a).

C. There is simply no escaping the fact that the decision below breaks new ground in dispensing with the *scienter* requirement heretofore embodied in the proscription of "knowing" and "willful" conduct. Petitioner is not simply calling into question "some of the language in the court of appeals' opinion" (Br. in Opp., p. 16). The court expressly held, in rejecting petitioner's challenge to the recklessness charge, that an accountant could be convicted of a felony for reckless conduct absent a conscious purpose to avoid learning the truth, as is required when others are prosecuted for "knowing" and "willful" conduct. The court held that a different standard was proper for members of the "ancient professions [law and accounting]" because they are under a "duty to discover the true facts." (Pet. App. 21a-22a). But as this Court has only recently noted, the imposition of sanctions for breach of a duty to inquire amounts to a negligence standard of criminal responsibility. *See United States* v. *Park*, 421 U.S. 658, 670-73, (1975). It is undeniable, therefore, that the court below has broken new and dangerous ground by criminalizing the failure to abide by a newly created "duty" to apply auditing procedures to unaudited figures.

In holding recently that § 10(b) of the Securities Exchange Act does not authorize an award of *civil* damages against an accountant unless an intent to deceive is proved, this Court drew attention to the precision with which Congress has specified the requisite state of mind accompanying each of the sanctions prescribed by the securities laws and emphasized the necessity of heeding the language of each statutory provision imposing liability. *Ernst & Ernst v. Hochfelder*, ____ U.S. ____ (No. 74-1042, March 30, 1976). As the Court noted there, while some sections of the 1933 Act impose civil liability upon accountants for negligent or innocent misrepresentation, § 18 of the 1934 Act, which imposes civil liability upon "any person who shall make or cause to be made" a materially false or misleading statement in any "application, report, or document filed pursuant to this title or any rule or regulation thereunder," requires more than negligence. Slip op. at 13-14, 24-25 n.31. The Court's discussion there of the language finally chosen by Congress showed that, in recognizing a defense based on "lack of knowledge" of falsity, Congress had rejected a standard that would have imposed *civil* liability on an accountant unless he had "no ground to believe that such statement was false or misleading." Because Congress appears to have insisted that only actual knowledge will justify imposing civil liability on accountants, the Court refused to suggest that even "recklessness" would be enough for *civil* liability. Slip op. at 7, n.12.

The Court's treatment of § 18 is particularly pertinent here because the language of that section defining proscribed conduct is virtually identical to the provisions of § 32(a) under which petitioner was charged. Yet in imposing criminal sanctions under

§ 32(a) Congress required a finding of *knowing* and *willful* submission of a false statement. It is simply inconveivable that in choosing this language Congress meant to make negligent or even reckless ignorance a federal felony when it simultaneously made "lack of knowledge" a complete defense to civil liability for the same conduct.

Moreover, as the Court noted in *Hochfelder*, Congress had no difficulty in spelling out with precision those instances in which it wished to impose a special standard of *civil* liability upon "experts," including accountants. To read § 32(a), a criminal statute addressed to "any person", as imposing a different standard of responsibility for accountants and lawyers—the express construction given it by the court below—is simply to disregard the "interrelated components" of the securities laws, as well as the language of § 32(a) itself. Slip op. at 20.

In proscribing knowing and willful conduct under § 32(a), Congress used words that this Court has consistently construed to embody "the central thought that wrongdoing must be conscious to be criminal." *Morrisette* v. *United States*, 342 U.S. 246, 252 (1952). In permitting petitioner to be convicted for failure to challenge "suspicious" figures, the court of appeals imposed criminal liability for "neglect where the law requires care, or inaction where it imposes a duty"—a standard of liability which this Court has always distinguished from that demanded by a proscription of knowing and willful conduct. *United States* v. *Park*, 421 U.S. at 671, *quoting Morisette*, *supra* v. *United States*, 342 U.S. at 255. Unless the Court is willing to acquiesce in this expansion of criminal liability under the securities laws, it must grant certiorari.

III.

THIS CASE PRESENTS AN IMPORTANT ISSUE OF SOUND JUDICIAL ADMINISTRATION TO ASSURE UNANIMOUS VERDICTS.

The government echoes the position taken by the court below in arguing that it may be "better practice" to instruct a jury that it must be unanimous as to which specification of a multi-specification count (if any) justifies conviction, but the government insists that this instruction is not Constitutionally compelled. That position fails to accord proper respect to the Constitutional guarantee of unanimity.

The issue here is closely related to the doctrine articulated in *Stromberg* v. *California*, 283 U.S. 359 (1931), that where a jury receives a case under alternative theories, one of which will legally support a conviction and one of which will not, the conviction cannot stand. This basic principle has been applied in many contexts.[13] As Mr. Justice White recently observed in his concurring opinion in *United States* v. *Gaddis*, ____ U.S. ____, ____ (No. 74-1141, March 3, 1976), slip op. at 2, the vice in such cases is that it is "impossible to know whether a properly instructed jury would have convicted the defendant of anything."

So too in the present case the jury was told that if it found the proxy statement false "in either one of" the two respects alleged in the indictment–which were

[13]*See, e.g., Street v. New York*, 394 U.S. 576, 585-86 (1969); *Williams v. North Carolina*, 317 U.S. 287, 292 (1942); *Vitello v. United States*, 425 F.2d 416, 419 (9th Cir. 1970); *United States v. Guterma*, 281 F.2d 742, 747-48 (2d Cir. 1960).

totally distinct and unrelated specifications of falsity "that is sufficient to support a conviction" (Tr. 2340). Petitioner, however, had a Constitutional right, reinforced by Rule 31(a) of the Federal Rules of Criminal Procedure, not to be convicted unless twelve jurors unanimously found against him on all of the facts necessary to support the government's charge. It places too much strain on the jury's ability to perform mental gymnastics to assume, as the government argues and as the court below held, that the jury "must" have understood the statement forty pages later that "your verdict must be unanimous" (Tr. 2380), as applying to the factual underpinnings as well as to the ultimate "verdict." Because the district judge refused to give the requested instruction that all jurors had to agree on at least one specification before they could convict, there is real danger than the jury did not unanimously find against petitioner on any particular state of facts. It is simply impossible to know.

The practice of joining multiple specifications of facts in a single count is not at all uncommon. The court below termed the objectionable instructions here those "generally given" in that circuit and held unnecessary any clarification in the future. The propriety of refusing to give instructions of the type sought here thus raises an important issue of the proper administration of criminal justice.

IV.

THE VENUE QUESTION MERITS REVIEW

The government's attempt to sustain venue in this case dramatically illustrates why the Court should take

this opportunity to provide much needed clarification of this cloudy area. The lower courts have struggled to understand the proper reach of *Travis* v. *United States*, 364 U.S. 631 (1961), and the government has come up with an ingenious approach to support the venue it selected in the present case without defending the decision by the court below that *Travis* should be regarded as "confined to the facts" in that case. (Pet. App. 30a).[14] There is no such easy way out.

Although the government attempts to distinguish the holding of the D.C. Circuit in the *Investors Funding* case,[15] it is undeniable that the court of appeals there regarded *Travis* as applying to the very venue provision at issue in the present case, § 27 of the Securities Exchange Act, 15 U.S.C. § 78aa, and as making venue proper in the District of Columbia, where a document was to have been filed with the Securities and Exchange Commission.

For the same reason, the fact that the proxy material was printed in the Southern District of New York does not suffice to lay venue there. Although the government invokes the "continuing offense" principle, that venue statute, 18 U.S.C. § 3237, is only operative "[e]xcept as otherwise expressly provided by enactment of Congress. . . ." In addition to the fact that

[14] It is certainly not true that the lower courts have refused to apply *Travis* to other factual situations. See, *e.g.*, in addition to the cases cited in this section, *United States v. Walden*, 464 F.2d 1015, 1018-19 (4th Cir.), *cert. denied*, 409 U.S. 867 (1972) (bank burglary); *United States v. Sweig*, 316 F. Supp. 1148, 1159-61 (S.D. N.Y. 1970) (conflict of interest in SEC matter).

[15] *Investors Funding Corp. v. Jones*, 495 F.2d 1000 (D.C. Cir. 1974).

Travis rejected the application of the "continuing offense" theory to a false-filing charge, there *is* a special venue statute that controls here, § 27 of the Securities Exchange Act, permitting venue in criminal cases only where the act or transaction "constituting the violation occurred." In *Pratt* v. *First California Co.*, 517 F.2d 11, 12-13 (10th Cir. 1975), the Tenth Circuit recently followed *Investors Funding* to hold that § 27 is an explicit venue statute that precludes application of other venue theories under § 3237. Significantly, none of the cases cited by the government invoking the "continuing offense" principle was covered by a special venue provision such as the one applicable to securities cases.

Furthermore, in accordance with the reasoning of *Travis*, lower courts have held that a false-filing violation occurs only where the filing takes place, not where preparatory conduct took place.[16] To the extent there is disagreement on this point, there is all the more reason for review by this Court.

The government's attempt to distinguish *Travis* by suggesting "jurisdictional" differences between the NLRB and the SEC does not reconcile the authorities

[16]*See, e.g., United States v. Valenti*, 207 F.2d 242, 243-45 (3d Cir. 1953) (NLRB); *United States v. Mischlich*, 310 F.Supp. 669, 671 (D. N.J. 1970), *aff'd sub nom. United States v. Pappas*, 445 F.2d 1194 (3d Cir.), *cert. denied*, 404 U.S. 984 (1971) (SBA).

The government cites *United States v. Bithoney*, 472 F.2d 16, 21-25 (2d Cir.), *cert. denied*, 412 U.S. 938 (1973), to sustain venue here. But the court there applied *Travis* to a statute punishing the "making" of a false statement in a petition required or authorized by the immigration laws, and held that for venue purposes the crime occurred where the document was filed, not where it was prepared and signed.

in this area. Moreover, the parallel between the statutory systems in *Travis* and in the present case cannot be so easily blinked. In this case, as in *Travis*, the criminal statute actually invoked was designed to keep a federal agency from acting on the basis of false information submitted to it,[15] and, as in *Travis*, there was no direct obligation to file the material. It follows that if any offense took place under the statute which petitioner was charged with violating, it took place only when and where the proxy statement was actually filed. If there is doubt about the current vitality and scope of *Travis*, it is for this Court to resolve.

V.

THE GOVERNMENT WITHHELD CRUCIAL FACTS FROM AND MADE AFFIRMATIVE MISREPRESENTATIONS TO THE JURY

The government flatly denies our contentions that the prosecutor misstated crucial facts to the jury. Yet the record shows at least two key statements in the prosecutor's summation that are directly contradicted by Randell's subsequent testimony as a government witness at the trial of Thomas Mullen. Compounding this error, the government continues to justify the conviction here by arguing that petitioner failed to respond properly to what are termed "extraordinarily suspicious" circumstances (Br. in Opp., p. 15). This is precisely our point: the true facts, unlike those portrayed to the jury and the court of appeals, are not so "suspicious" at all.

Summing up at petitioner's trial, the prosecutor stated:

> . . . [T]hey are printing up this very proxy statement, there's going to be a big hole in the

[17]We reiterate that this is a false filing case, not a case where the circulation of fraudulent proxy material to shareholders was the offense charged.

> earnings because *the Pontiac contract has to come out.*
>
> By magic 3 o'clock in the morning *the first time it is mentioned* the Eastern Airlines contract comes up. (Tr. 2295) [Emphasis added].

The prosecutor thus told the jury that petitioner had first told Randell his objection to the Pontiac contract on the night the proxy statement was being printed, and that Randell had immediately suggested replacement with the Eastern contract. Both statements are contradicted by Randell's subsequent testimony at the Mullen trial. As Randell testified there, petitioner told him some time before the evening at the printer that he would object to inclusion of Pontiac figures in financial statements, and on learning this Randell asked his account executives whether there were any other contracts for which commitment letters had been or could be obtained (Mullen Tr. 46).

Referring to the Eastern contract at petitioner's trial, the prosecutor stated:

> It is supposed to be a contract for the period which ended two months before and yet in the two months between May and August, nobody seems to have peeped a word [about] it to the controller of National Student Marketing *or anybody else who had any business with this matter.* (Tr. 2295-2296) [Emphasis added].[18]

[18]Since Natelli had advised the company in December 1968 that in the future income should not be recorded on client commitments until a written commitment letter was received (Tr. 530, 673), there was no significance to the fact that the financial officers of the company, who had their offices in Washington, were not told of the earlier oral commitment from Eastern by the account executives in New York, who were working on the Eastern account.

Nor was it ground for "suspicion" that prior to August 14, 1969 there was no record of expenditures on the Eastern contract or

(continued)

This assertion that no responsible person at NSMC had any contact with the Eastern commitment between May and August was contradicted by Randell's later testimony about his conversation with Dennis Kelly, NSMC's Vice President in charge of sales, immediately after petitioner first objected to the Pontiac commitment:

> He [Kelly] said he had been working on a contract with Eastern for a number of months and he felt as though it was at the point that he could get a commitment letter on that. He didn't know but he would see if he could.
>
> * * *
>
> Q. Did Kelly say anything else to . . .
>
> A. Yes, he said Bob had been working with Tom [Mullen of Eastern Airlines] for a number of months.
>
> Q. Bob who?
>
> A. Bob Bushnell [an NSMC Vice-President in charge of the Eastern account].
> (Mullen Tr. 46-47)

Thus, the Eastern commitment was not, as the prosecutor asserted, something unknown to anyone at NSMC between May and August. Rather, it was a commitment which the Vice-President in charge of sales and the Vice-President in charge of the Eastern account had been working on throughout the period, and which

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(footnote continued from preceding page)

billing to Eastern, since that was consistent with the percentage-of-completion accounting employed by NSMC. This method of accounting was adopted because it was not possible to segregate the overhead and other expenses attributable to the creative efforts expended in developing programs for prospective clients prior to the time the client committed itself to the program. *See* Pet. 6-7.

Kelly believed he could reduce to a commitment letter in the form necessary to support the accrual of income.

The government blithely asserts that Randell's testimony "in no way bears on petitioner's state of mind" (Br. in Opp., p. 29). On the contrary, the prosecutor's statements in summation concerned what petitioner did and what "facts" had confronted him—matters of the utmost relevance to the inferences the prosecutor asked the jury to draw about petitioner's culpability. Randell's later testimony contradicts the prosecutor on these key points and indeed tends to corroborate petitioner's testimony that Randell told him prior to the meeting at the printer that NSMC was expecting a commitment letter from Eastern (Tr. 1913-14).

The government's assertions about the Eastern contract at petitioner's trial misled not only the jury, but had discernable impact upon the court of appeals, which wrote that "the Eastern contract was a matter for deep suspicion because it was substituted so rapidly for the Pontiac contract . . ." (Pet. App., p. 15a).

The complete account, including Randell's later testimony, places the Eastern commitment in a critically different context. Prior to the meeting at the printer, petitioner had told Randell that the Pontiac letter was not in the proper form to justify the accrual of revenue. After talking to Kelly and learning that an oral commitment from Eastern could be reduced to writing, Randell told petitioner that the company was expecting a letter from Eastern confirming an earlier oral commitment. When Randell brought up the Eastern commitment at the printer again, therefore, it was neither a sudden appearance nor a matter for suspicion. Even so, petitioner did not make any decision concerning the

Eastern commitment until the following week, after examining the commitment letter itself, reviewing the detailed proposal brochure NSMC had submitted to Eastern in May, discussing the matter with NSMC's Vice-President in charge of sales, and reviewing Bushnell's time records which showed an expenditure of more than 110 hours on this project prior to the end of May.[19]

The misstatements in the summation as to the "magical" Eastern commitment, which allegedly sprang to life full blown at 3:00 A.M. at the printer, were not simply the result of a slip of the tongue in the heat of argument. Rather, this was a theme of the government's presentation throughout the trial, starting with a similar assertion in the prosecutor's opening statement (Tr. 55-56), developed further during the examination of the government's witnesses (Tr. 257-259, 653-655), and highlighted in the cross-examination of petitioner himself. (Tr. 2047-2048). Having reiterated this theme throughout the case, the prosecutor twice in his summation referred to the appearance of the Eastern commitment letter as "magical" and three times stressed that this occurred at "3:00 o'clock in the morning" (Tr. 2268-2269, 2295, 2296).

[19]As Randell's subsequent testimony makes quite clear, there was never the kind of single transaction "substitution" of Eastern for Pontiac, as the government argued. While Randell had proposed at the printer to "substitute" Eastern for Pontiac without changing the figures in the unaudited statement, petitioner unrequivocally rejected this suggestion. Only after examining company documents several days later did petitioner make the separate decision that he would not object to inclusion of the Eastern figures. It was Randell's suggestion not to bother recomputing the figures, which petitioner rejected, that petitioner had called "wierd"; this was not, as the government successfully argued to the court below, petitioner's characterization of the Eastern commitment or its ultimate inclusion in the unaudited financials. (Pet. 17-18 n.9).

The government now suggests that any misstatement of the facts was inadvertent. That claim must be judged against the fact that prior to this trial Randell had pleaded guilty and testified before the grand jury in the Mullen case. Yet the government did not call him to testify here, even though without his testimony there was no proof the Eastern commitment was, in fact, "phony" as the government counsel argued.[20]

But even if the misstatements contained in the government's opening statement and summation were inadvertent, there can be no question that the jury was seriously misled by the government's statements concerning one of the most crucial events at issue and the event that led the court below to conclude that the figures confronting petitioner were "suspicious." In such circumstances summary reversal is required even if the government's counsel did not knowingly misrepresent the facts. *United States* v. *Ott*, 489 F.2d 872, 974-75 (7th Cir. 1973) (Stevens, J.).

While the government urges this Court to overlook these circumstances and leave petitioner to pursue them in collateral proceedings, this Court has unquestioned power to make its own determination, or to remand the case for further proceedings on this point. *See Ring* v. *United States*, 419 U.S. 18 (1974).

[20]Randell's testimony would have shown that in order to obtain the type of letter from Eastern the accountants required, he had to give Mullen a side letter making the commitment cancellable at any time and that Randell deliberately kept the existence of this side letter a secret from petitioner (Mullen Tr. 53-54). Moreover, Randell's testimony would have revealed that he had concealed from petitioner the fact that Mullen had no authority to commit Eastern to purchase NSMC's services. Given the government's suppression of that fact, it is not entitled to rely upon it here. (Br. in Opp., p. 29).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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